

STATE OF MICHIGAN  
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES  
FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the matter of the Application of	)	
<b>Consumers Energy Company</b> for	)	Case No. U-15986
Authority to increase its rates for the	)	
distribution of natural gas and for other relief.	)	
_____	)	

**NOTICE OF PROPOSAL FOR DECISION**

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on March 24, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before April 7, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before April 21, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE  
HEARINGS AND RULES  
For the Michigan Public Service Commission

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Mark D. Eyster  
Administrative Law Judge

March 24, 2010  
Lansing, Michigan  
dmp

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**PROPOSAL FOR DECISION**

**Issued and Served: March 24, 2010**

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**PROPOSAL FOR DECISION**

**HISTORY OF PROCEEDINGS**

Consumers Energy Company (Consumers) is a regulated utility engaged in purchasing, storing, transporting, distributing, and selling natural gas to more than 1.7 million customers in the State of Michigan. Consumers' natural gas system is an integrated and interconnected entity. It is operated as a single utility system in which the same rates and tariffs apply.

On May 26, 2009, Consumers filed this application requesting, among other things, approval of rates designed to increase annual gas revenues by approximately \$114.4 million. Consumers' application was filed pursuant to the provisions of 1909 PA 300, as amended, MCL 462.2 et seq; 1919 PA 419, as amended, MCL 460.54 et seq; 1939 PA 3, as amended, MCL 460.1 et seq; and 1982 PA 304, as amended, MCL 460.6h(1) et seq. Prior to this filing, the Michigan Public Service Commission (Commission) last approved Consumers' retail natural gas transportation, storage, and distribution rates in its December 23, 2008, Order Approving Settlement Agreement, in Case No. U-15506.

In this matter, a prehearing conference was held June 24, 2009, before Administrative Law Judge (ALJ), Mark D. Eyster. At the conference, counsel appeared on behalf of Consumers, the Michigan Public Service Commission staff (Staff), the Attorney General for the State of Michigan (Attorney General), the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), the Association of Businesses Advocating Tariff Equity (ABATE), the Interstate Gas Supply Inc. (IGS), the National Energy Marketers Association (NEMA), the Michigan State Utility Workers Council (MSUWC), and the Midland Cogeneration Venture Limited Partnership (MCV). Intervenor status was granted to the Attorney General, RRC, MCAAA, ABATE, MCV, MSUWC, and, jointly, to IGS and NEMA. A schedule for the remainder of the case was established. On September 14, 2009, late intervention was granted to Constellation NewEnergy-Gas Division, LLC (CNE).

On October 13, 2009, the Commission ordered Consumers to file, by October 16, 2009, a tariff showing the rates that Consumers proposed to self-implement, pursuant to MCL 460.6a(1). Additionally, pursuant to the October 13, 2009, order, an evidentiary hearing was held on October 27, 2009, for Consumers to provide evidence to support the reasonableness of the proposed rates. On November 19, 2009, Consumers self-implemented a rate increase designed to produce an additional \$89 million in annual natural gas revenue.

Pursuant to the schedule adopted at the prehearing conference, Staff and Intervenor testimony and exhibits were filed on October 22, 2009, and rebuttal testimony and exhibits were filed on November 16, 2009. Evidentiary hearings were conducted on December 14, 15, 16, and 18, 2009, and on January 7, 2010. The

evidentiary record in this matter consists of a transcript, 1,217 pages in length, and 173 exhibits.

On January 27, 2010, briefs were filed by Consumers, Staff, ABATE, the Attorney General, MCAAA, and CNE. On January 28, 2010, MSUWC filed its initial brief along with a motion to permit its late filing. The motion was granted. The Attorney General filed a confidential brief on February 1, 2010. Reply briefs were filed on February 10, 2010, by Consumers, Staff, ABATE, the Attorney General, MCAAA, and CNE.

### **POSITIONS OF THE PARTIES**

#### **Consumers Energy**

Consumers requests authority to revise its rates so as to raise an additional \$103.8 million annually. Consumers projects a 2010 test year rate base of \$2,754,695,000 and recommends an 11.00% return on equity in its cost of capital projection of 7.32%. Consumers proposes the adoption of a Revenue Decoupling Mechanism (RDM), an Uncollectible Expense Tracker Mechanism (UETM), a Pension Equalization Mechanism (PEM), and an Other Post Employment Benefits (OPEB) mechanism. Consumers is proising expenditures on its Advanced Metering Infrastructure program (AMI). Consumers projects deliveries of 271,575,000 Mcf and an average customer total of 1,682,271. Consumers is recommending an equal percentage increase of 16.7% for all sales rates. For transportation rates, Consumers recommends a 20.6% increase.

## Staff

Absent rate relief, Staff calculates a revenue deficiency of \$62,710,000 for the 2010 test year. Staff attributes the difference between its and Consumers' estimate primarily to Staff's lower rate base, lower rate of return, and higher Net Operating Income. Staff recommends the following: a 2010 test year rate base of \$2,754,695,000; a cost of equity of 10.70% in its overall cost of capital determination of 7.05%; a Company Adjusted Net Operating Income requirement of \$156,064,000; that the Commission not approve the UETM, PEM, and OPEB mechanisms; that the Commission accept Consumer's projected total deliveries of 271,575,000 Mcf and average customer total of 1,682,271; that the Commission use Staff's Cost of Service Study to calculate the revenue requirement for each rate schedule, and; that the Commission adopt Staff's rate design methodology, as found in Exhibit S-5, Schedule F-1-2.

## Attorney General

With regard to gas delivery projections, the Attorney General opposes Consumers' use of 15 years of weather data, rather than 30 years, for weather normalization. The Attorney General opposes the adoption of a RDM and, in the alternative, recommends adoption of a RDM that only recognizes lost sales due to energy conservation. The Attorney General opposes Consumers' proposals for the UETM, PEM, and OPEB mechanisms. The Attorney General calls for a freeze of certain Operation and Maintenance expenses at 2008 levels. The Attorney General is calling for \$173.6 million less in capital expenditures than that proposed by Consumers and a complete halt to spending on the AML. The Attorney General argues that the

Commission lacks authority to permit Low Income Energy Efficiency Fund expenditures. The Attorney General argues that Consumers' Long-Term Debt, Preferred Equity, and Common Equity capital structure should mirror that of its parent corporation, CMS Energy, and recommends a return on common equity of 10.09%, an overall return on capital of 6.17%, and \$12.3 million in rate relief.

### ABATE

ABATE argues that Consumers' proposed transportation rates are unjust and unreasonable because Consumers' cost of service methodology over-allocates storage costs to transportation customers. ABATE is not taking a position regarding the level of any rate increase. However, ABATE believes the increase for transportation customers should be less than the average increase for all customers.

ABATE opposes Consumers proposed revenue decoupling mechanism and argues that if a decoupling mechanism is approved by the Commission it should be limited to revenue lost due to Consumers' energy optimization plan and, if the Commission approves a more broad mechanism, that it be based upon class revenue, rather than average customer use. Furthermore, ABATE opposes Consumers' proposals for the UTM, PEM, and OEM. ABATE supports CNE's pooling proposal.

ABATE agrees with the Attorney General's proposals to not increase O&M expense above the 2008 level of \$196.1 million and to limit capital expenditures to 315.5 million. Further, ABATE supports the Attorney General's proposal to cut the AMI.

ABATE argues that there is no longer statutory authorization for the LIEEF and the Commission should not approve of expenditures for this program. Finally, ABATE

recommends a return on equity of 10.09%, reduced by 50 basis points, should the Commission approve revenue decoupling.

#### MCAAA

MCAAA argues for exclusion of Consumers' Department of Energy (DOE) liability, including principal and interest, from Consumers' rate base. Further, MCAAA argues that no cost should be assigned to DOE liability. Additionally, MCAAA argues that no costs of a Letter of Credit, associated with the DOE liability, be recognized in this case. MCAAA continues by arguing for establishment of an external interest bearing trust fund for the DOE liability. MCAAA recommends rejection of Consumers' proposed Uncollectibles True-up Mechanism. Finally, MCAAA supports Consumers' proposed expenditures for the LIEEF program.

#### Michigan State Utility Workers Council (MSUWC)

MSUWC generally supports Consumers' request for increased rates and recommends that the Commission implement a rate increase to address employee training issues through establishment of a Taft-Hartley Training Trust.

#### Constellation NewEnergy, Inc. (CNE)

CNE is taking no position on matters other than its proposal requiring Consumers to allow suppliers to combine transportation customers into pools. Specifically, CNE recommends that the Commission require Consumers to accept pooled nominations from marketers, modify Consumers' tariff to assess charges based upon the net imbalance of the marketers pool, implement pooling of transportation customer storage,

and require that monthly injection rights be established based upon the pool member's individual tariff rights.

### **TEST YEAR**

As the Commission stated, at *Application of Detroit Edison Co*, U-15768, Opinion and Order, pp. 9-10 (Jan. 11, 2010):

A test year is the starting point for establishing just and reasonable rates for both the regulated utility and its customers. A test year is employed by the Commission to establish representative levels of revenues, expenses, rate base, and capital structure for use in the rate-setting formula.

The selection of an appropriate test year has two components. First, a decision must be made regarding a 12-month period to be used for setting the utility's rates. A second determination must then be made regarding how the Commission should establish values for the various revenue, expense, rate base, and capital structure components used in the rate-setting formula. The Commission may use different methods in establishing values for these components, provided that the end result is a determination of just and reasonable rates for the company and its customers.

As the Commission discussed in its November 2, 2009 order in Case No. U-15645, p. 8, Section 6a(1) of Act 286, MCL 460.6a(1), provides that a utility "may use projected costs and revenues for a future consecutive 12-month period" to develop its requested rates and charges. The Commission added that the Staff and intervenors should direct their focus "upon the strengths and weaknesses of the evidentiary presentations of the parties regarding specific expense and revenue projections." In a case where a utility decides to base its filing on a fully projected test year, the utility bears the burden to substantiate its projections. Given the time constraints under Act 286, all evidence (or sources of evidence) in support of the company's projections should be included in the company's initial filing. If the Staff or intervenors find insufficient support for some of the utility's projections they may endeavor to validate the company's projection through discovery and audit requests. If the utility cannot or will not provide sufficient support for a particular revenue or expense item (particularly for an item that substantially deviates from the historical data) the Staff, intervenors, or the Commission may choose an alternative method for determining the projection.

In this case, Consumers has selected calendar year 2008 as its actual historical year. Tr 3, p. 451. To the 2008 historical year, Consumer made adjustments to develop a Projected Test Year covering the 12-months ending September 30, 2010. Tr 3, p. 451. No party has objected to use of this Projected Test Year.

### **RATE BASE**

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements.

For the 2010 projected test year, Consumers has adopted Staff's proposed rate base of \$2,754,695,000. This figure includes \$1,708,873,000 for net utility plant, \$1,025,422,000 for working capital, and \$21,164,000 for unamortized MGP expense. This figure is adopted.

#### **Net Utility Plant**

Included in net utility plant is \$426,351,000 in gas capital expenditures for 2009 and the first nine months of 2010 in the following seven categories: New Business, Asset Relocation Regulatory Compliance, Material Condition, Capacity/Deliverability, Gas Operations Other, and Gas Business Services. Exh. A-34. Additionally, Consumers proposes capital expenditures on its AMI in the amounts of 8,097,000 for 2009 and 22,894,000 for the first nine months of 2010. Exh. A-34. Also, an additional \$31,752,000 of capital expenditures is proposed for Corporate Services. Exh. A-12. Staff accepts these expenditures.

The Attorney General, however, argues against adoption of these projected expenditures and, instead, recommends total capital expenditures of \$315.5 million,

rather than the \$489.1 million proposed by the Company. AG Initial Brief, p. 19. The Attorney General argues that the “lack of any cost/benefit analysis alone” demonstrates that Consumers’ increase in capital expenditures is unreasonable. AG Initial Brief, p. 16.

To support his recommendation, Attorney General witness, Mr. Coppola testified, at Tr 6, pp. 1143-45, that:

[Consumers] is proposing to incur \$489.1 million of capital expenditures between the year 2009 and the 9-months ending September 2010. From 2006 to 2008, the Company had capital expenditures of approximately \$170 million annually.

\* \* \*

This high level of capital expenditures during a 21-month period would result in a 31% increase in Net Utility Plant between 2008 and the end of the forecasted test year. . . . Such a level of increase is unusual for a utility in a mature sales market with a declining customer base. Of the \$489.1 million in forecasted capital expenditures only \$31.1 million readily appears to be revenue generating (New Business). This is approximately 6% of the total. The remaining 94% of capital expenditures have no new incoming revenue associated with them and therefore require higher rates to customers for the Company to recover its investment. Potentially, some of these expenditures may lower operating costs, but the Company has not identified any specific numbers. As a matter of fact, in response to an AG discovery request (see Exhibit AG-10) to provide cost/benefit analyses of its major capital expenditures, the Company did not provide any quantifiable information.

\* \* \*

The impact on rate base and customer rates of this large increase in capital expenditures is very significant. Although Exhibit A-6 (DSA-38) shows the \$436.1 million increase in Net Utility Plant (net of depreciation) is partially offset by a reduction in Working Capital, Rate Base is still increasing by approximately \$270 million or more than 10% over the 2008 level. This increase in Rate Base accounts for \$32.1 million or 28% of the \$114.4 million in revenue deficiency the Company is seeking to recover in higher rates to customers.

At a time when the Company is facing significant losses in its gas markets and revenue reduction, I find it perplexing that the Company would propose such a significant increase in capital expenditures. Typically businesses facing significant lower revenue and cash flow decide to cut capital expenditures and defer projects to future years when

the business rebounds. The Company does not seem to operate in such a business mind set. In response to AG discovery questions (see Exhibit AG-10) about the possibility of deferring some of the proposed capital projects, [t]he Company says that: "These specific expenditures . . . are necessary to continue to provide safe and reliable service to our customers."

Many other businesses in Michigan have undertaken significant cost reductions and restructuring initiatives to survive. Utilities cannot be insulated by these realities. To continue to increase the cost structure in a declining sales and transportation market, and to just increase rates to make up the revenue shortfall is not a supportable business model for the long term. Businesses typically do not increase their costs and increase their prices when they face declining markets. This would be a sure formula to go out of business. Instead, they rationalize each business operation, cut operating costs and capital expenditures, and double their effort to increase sales.

Similar to higher O&M costs, higher capital expenditures with minimal new revenue accompanying those expenditures create a terrible business model. The increasing cost structure reflected in higher rates becomes burdensome and unfair to both residential and business customers of the utility. Businesses are struggling to stay competitive and survive. They are looking to find ways to cut costs. The last thing they need is significantly higher gas costs.

More specifically, the Attorney General recommends Commission approval of only \$55 million of the \$80.16 million proposed by Consumers for Regulatory Compliance. The \$55 million figure "is based on the average spent during 2006-2008".  
Tr 6, p. 1146.

However, Consumers provided testimony, at Tr 3, pp. 409-10, to establish that:

The Regulatory Compliance Program includes projects that are required to comply with federal pipeline safety regulations. These projects include the Meter Move-Out Project and other Meter Replacements, Pipeline Integrity, Cathodic Protection and Regulation projects. The capital expenditure projections for this program are \$44,136,000 for the year 2009 . . . and \$36,020,000 for the 9 months ending September 2010 . . . . The changes in this program are based on normal economic pressures such as wages and material costs, and projects identified through system assessments. The Pipeline Integrity program expenditures change from year to year because of work scope variations, which are driven by assessments of threats and risk translating to a priority-based inspection schedule, and the expected remediation costs

resulting from the findings of these inspections. This program is performed in compliance with the federal Pipeline and Hazardous Materials Safety Administration requirements. Additional projects such as distribution pipeline augmentation and system regulation improvements were identified as necessary to ensure compliance with Maximum Allowable Operating Pressure regulations and are included in the program.

With regard to Material Condition, the Attorney General recommends approval of \$30 million in expenditures, "which is based on the average spent during 2006-2008." Tr 6, p. 1146.

Consumers supports this projected \$75.1 million expenditure with testimony, at Tr 3, pp. 410-11, establishing that:

As shown on Exhibit A-34 (DDH-8), the capital expenditure projections for this program are \$29,622,000 for the year 2009 (line 4, column (b)) and \$45,480,000 for the 9 months ending September 2010 (line 4, column (c)). The increases in this program for the 9 months ending September 2010 are due to reestablishing our material condition replacements in line with project decision analysis results, and restarting a program to replace remaining cast iron pipe.

\* \* \*

Approximately 630 miles (2.5%) of our distribution main miles are cast iron pipe. Installation of some of this pipe dates back to the 1880s. Because cast iron operates at low pressure, it is more susceptible to ground water infiltration and freeze-ups in winter as compared to more modern materials. The cast iron is located mainly in older neighborhoods, and freeze-offs can cause severe customer hardship. In recent years, freeze-ups of cast iron pipe have escalated and have led to considerable customer service interruptions. These customer service interruptions have been particularly frequent in the cities of Flint and Saginaw and have generated numerous customer complaints. Capital expenditures of \$18,000,000 are included the 9 months ending September 2010 figure to address this issue more aggressively by replacing approximately 25 miles of cast iron pipe and upgrade the distribution system associated with the pipe replacement to a higher operating pressure.

Additionally, the Attorney General recommends approval of only \$120 million of the \$174.3 million in Capacity/Deliverability expenditures forecasted by Consumers.

With regard to these expenditures, Consumers provided the following unrebutted testimony, at Tr 3, p. 411:

These capital expenditures reflect needed increases in transmission pipeline capacity, as well as storage and compression reliability, all intended to ensure adequate capacity and deliverability throughout the system. Capacity requirements increase due to shifts in population into new locations, as well as changes in system requirements such as the need to support load and maintain pressure (both base and peak day), as well as to provide capacity in order to inspect and remediate segments of pipe in the Pipeline Integrity program. Expenditures associated with many of the larger projects within this program can be found in Exhibit A-39 (DDH-13). In particular, these numbers reflect capital expenditures of \$40,000,000 for the year 2009 and \$511,000 for the 9 months ending September 2010 for capacity increases in the West Oakland Pipeline, Phase 2. . . . This project received a Certificate of Necessity and Convenience, and Phase 1 was installed in 2005. This second phase will complete the construction required to provide peak day capacity to much of our system in Southeast Michigan, where capacity constraints are increasing. Completion of West Oakland Phase 2 is also needed to take other transmission pipelines temporarily out of service for inspections and maintenance as required by the Pipeline Integrity program.

\* \* \*

Another capacity and deliverability project included in this program is the Dewitt Pipeline Improvement project, projected at \$1,000,000 for the year 2009 and \$5,965,000 for the 9 months ending September 2010. This project was also issued a Certificate of Necessity and Convenience from the MPSC in February 2007. The project includes necessary upgrades to a 20" transmission pipeline and the associated city gate enhancement.

\* \* \*

Another major project is the White Pigeon Compressor Station Improvement project. The projections reflect \$49,498,000 for the year 2009 and \$5,900,000 for the 9 months ending September 2010. Costs of new compression are based on projections for engines and compressor units between \$3.5 million and \$5 million depending on unit size. That projection then factors in cost of site preparation, piping changes and labor. . . . This project will provide four additional units at White Pigeon to ensure that the station's compression requirements are fulfilled in the future. White Pigeon is the largest system receipt point by volume on the Company's Gas T&S system. This project will address an existing deficiency in compression availability. These compressors are over 35 years old and replacement parts must now be reverse-engineered from

old parts, as they are no longer available -- a process that is very costly and not always successful.

\* \* \*

Another project is the Ray Compression Station Upgrade. The projections reflect \$2,000,000 for the year 2009 and \$41,604,000 for the 9 months ending September 2010. This project will provide five additional units to improve station reliability. With respect to serving gas customers throughout the winter heating season, Ray Storage Field is the most critical asset on the Company's Gas T&S system. From a design perspective, Ray Storage Field is expected to provide over 50% of the total peak day storage field withdrawal capability and over 40% of the total system supply capability. This project will ensure that sufficient compression is available during the storage field injection cycle. This project is also the first of three phases designed to ultimately increase the cyclic capacity of the storage field itself.

\* \* \*

Finally, there are capital investments projected at \$3,900,000 for the year 2009 and \$4,509,000 for the 9 months ending September 2010 for new wells, which are needed to maintain required deliverability from existing storage fields, as storage wells naturally deteriorate over time.

The Attorney General recommends adoption of Consumers' projected expenditures of approximately \$31 million and \$34.4 million for New Business and Asset Relocation, respectively.

Addressing Consumers' AMI, the Attorney General argues against any further spending on this program by stating, at AG Initial Brief, pp. 19-21.

Consumers proposes to initiate an AMI pilot program with the objective to fully implement AMI by 2015. (Tr 1147). The concern about this new AMI pilot program is not whether or not AMI is a good technology or whether it will provide some benefit to customers. Rather, the concern is whether Consumers has shown that it is reasonable to expend \$230 million in capital expenditures by the end of 2015 which increases cost of capital by millions without providing any cost/benefit analysis to determine if the benefits to the company and customers outweigh the costs. Consumers has already incurred \$10.1 million in capital expenditures for this project and is proposing to incur a[n] additional \$31 million to assess, develop, and evaluate systems and field equipment -- all without ever conducting a cost/benefit analysis or . . . providing a cost benefit analysis to support its request in this filing. (Tr 1147). Although Consumers has provided some general ideas of savings in response to the Attorney

General's discovery request for a cost/savings analysis, Consumers has not done the type of detailed cost/savings analysis a reasonable person would expect before expending millions of dollars in study and hundreds of millions of more to implement the AMI project. (Tr 1148). As stated above, Consumers bears the burden of proof in this rate case. Consumers must show the reasonableness of its rate increase request. Absent a detailed cost/benefit analysis showing the reasonableness of these costs, the Commission should reject Consumers' proposed AMI project and require such a study before approving it.

In addition to the lack of a cost/benefit analysis, there is the timing of the AMI project that is a concern. As Mr. Coppola explained:

The second issue I have with the Company's proposal is with its timing. Beginning such a program in the midst of a severe economic recession in Michigan, when the Company is facing lower gas revenue, requires the Commission to grant higher rates to the Company to recover the cost of this investment. As I described above under the Capital Expenditures section of my testimony, higher capital expenditures increase the Company Rate Base. Each \$30 million increase in rate base translates into approximately \$2.2 million in first year cost of capital if we apply the Company's proposed cost of capital rate. This cost will increase accordingly as the entire \$230 million in capital expenditures are made to implement the entire program. Such a costly program if properly justified should be deferred until economic conditions in Michigan improve and the Company's revenues rebound to at least partially offset the impact on customer rates. (Tr 1148-1149).

Accordingly, the Attorney General requests that the Commission not approve any capital expenditures for the AMI program and require Consumers to file a comprehensive cost/benefit analysis about the AMI program in its next rate case and defer incurring any further capital expenditures until the Commission has approved continuation of the program. (Tr 1149).

Additionally, the Attorney General recommends "\$45 million in other areas, which represent Company proposed expenditures for 2009. The Company has projected \$93.9 million for this remaining group for the forecast period." AG Initial Brief, p. 18. While not entirely clear from the record, it appears that this recommendation relates to proposed expenditures for Corporate Services, Gas Operations Other, Gas Business Services, and the AMI Program.

Finally, the Attorney General argues, at AG Initial Brief, p.19, that:

The Commission should . . . order [Consumers] to undertake[] a more critical review of the remainder of its capital expenditures program for 2010 and find ways to minimize non-revenue generating capital investments, defer certain essential programs to future years when revenue levels have rebounded or end those less essential capital programs. Such a detailed review could best be done in collaboration with the Commission Staff and other interveners. The Company should be challenged to provide quantifiable benefits for each sizable capital program it wants to undertake along with a complete cost/benefit analysis to aid in the decision process.

To some degree, the Attorney General's arguments and recommendations are appealing. Consumers' and Staff's recommendation regarding Capital Expenditures certainly seems to ignore the current state of Michigan's economy and the need for belt tightening at every level, including the State's utilities. However, for the most part, the Attorney General's recommendations are short on specifics. Instead, they seem characteristic of general policy decision that might be made by business executives facing financial crisis. As such, it is difficult, as an ALJ, to make findings that would support adoption of these general policy statements. Based on the evidence presented, it appears that Consumers' projected expenditures are related to concrete projects that are reasonable. I suspect that the Attorney General is, indeed, correct that a number of projects might be delayed and/or their costs reduced.<sup>1</sup> However, the Attorney General has failed to identify what projects these might be. Without a more specific and detailed review of Consumers' capital expenditures, I, as an ALJ, feel constrained to find that the capital expenditures projected by Staff and Consumers are reasonable.

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<sup>1</sup> For instance, one such project might be the Dewitt Pipeline Improvement project, mentioned above. When that project was approved by the Commission in 2007, Consumers estimated its cost at \$3.6 million. In this filing, Consumers now identifies costs of approximately \$7 million and it is not apparent that this is the total projected cost for the project. Additionally, the project was, at least, in part, designed to address projected growth in gas sales to the Lansing area. Given Consumers' current projected drop in sales, one wonders if this and other projects might be delayed until such time as sales actually begin to increase. See Case No U-14421.

### Working Capital

Consumers adopts Staff's calculation of total working capital of \$1,025,422,000, as shown on Exhibit S-2, Schedule B-4. Consumers Initial Brief, p. 7. This figure is adopted.

To determine Working Capital, "Staff used the balance sheet working capital methodology, approved in Case No. U-7350, to determine 2010 projected year working capital requirements. . . . Staff's proposed adjustments are consistent with the position adopted previously by the Commission [and] . . . are based on information provided in the Company's filing or by the Company in response to Staff inquiries." Tr 4, p. 562.

For the 2010 projected year, Staff removed \$457,000 from accounts receivable in Working Capital resulting in a balance of \$1,025,422,000. Tr 4, p. 562, Exh. S-2, Schedule B-4. Staff made this adjustment to remove accumulated bad debt expense related to PeopleCare. Staff states that PeopleCare is made up of Company employee, and customer donations and that feels these donations should not be included in Working Capital. In Case No. U-15245, the Commission adopted a similar adjustment. Tr 4, p. 562.

### Manufactured Gas Plant Recovery

Consumers has identified 23 former manufactured gas plants (MGP) sites in which it has a present or former ownership interest. See Exh. A-48. Gas was manufactured at these sites from the late 1800s until the 1950s. Tr 4, p. 539. Manufactured gas production created various environmentally harmful by-products and soil and water contamination has been discovered at all 23 sites. Tr 4, p. 539. Under

current environmental standards, Consumers will incur clean-up costs at all of the sites. Tr 4, p. 539. Therefore, Consumers is seeking approval of approximately 3.81 million related to investigation and remediation of MGP sites. Tr 4, p. 537.

As Staff explains, at Staff Initial Brief, pp. 7-8:

To account for these costs, the Commission has approved deferred cost accounting for the MGP Costs, separated by vintage year, along with a ten year amortization methodology to allow Consumers to recover those costs over time. These expenses are also to be offset by any insurance recoveries, which are also to be deferred and amortized over ten years following the year of its recovery. This was mandated by the Commission for Consumers in its order in Case No. U-10755, dated 3/11/1996. [4 Tr 765.]

\* \* \*

Staff has used the latest information available at the time the case was compiled, as shown on Exhibit S-2, Schedule B-4.1. For all items, this was the month of August, 2009.

Staff has calculated Consumers' MGP unamortized balance to be \$21,163,526 and Consumers agrees. Staff Init Br, p. 7. Consumers Reply Brief, p. 5. This figure is adopted.

### **RATE OF RETURN**

As the Commission stated, at *Application of Detroit Edison Co*, U-15768, Opinion and Order, pp. 16-17 (Jan. 11, 2010):

The criteria for establishing a fair rate of return for public utilities is rooted in the language of the landmark United States Supreme Court cases *Bluefield Water Works Co v Public Service Comm of West Virginia*, 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Comm v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944). The Supreme Court has made clear that, in establishing a fair rate of return, consideration should be given to both investors and customers. The rate of return should not be so high as to place an unnecessary burden on ratepayers, yet should be high enough to ensure investor confidence in the financial soundness of the enterprise. Nevertheless, the determination of what is fair or reasonable, "is not subject to mathematical

computation with scientific exactitude but depends upon a comprehensive examination of all factors involved, having in mind the objective sought to be attained in its use.” *Meridian Twp v City of East Lansing*, 342 Mich 734, 749; 71 NW2d 234 (1955).

#### Capital Structure, Cost Rates, and Rate of Return

As stated at, Staff Initial Brief, pp. 8-9:

Staff determined Consumers overall rate of return by using a forecast of the Company's 2010 capital structure, adjusting the Company's debt and equity balances by anticipated changes to those balances. Staff used a proxy group of 12 publicly traded natural gas utility companies to aid in determining a reasonable return on equity for Consumers and employed the Discounted Cash Flow (DCF) method and the Capital Asset Pricing Model (CAPM) to the proxy group. 4 TR 706. Staff also employed a risk premium model and reviewed other state commissions' gas utility ROE decisions to aid in determining its cost of equity range. Staff recommended a cost of equity range of 10.45% - 10.95% and used the midpoint of the range, 10.70%, in its overall cost of capital determination of 7.05%. 4 Tr 706.

Consumers has adopted Staff's balances for each capital structure component, with the exception that Consumers removes \$163 million in DOE Liability from the long-term debt balance. Consumers Initial Brief, p. 14. Using methodologies similar to Staff's, Consumers developed an 11% cost of equity and an overall rate of return of 7.32%. Consumers Initial Brief, p. 41.

The Attorney General recommends that, with respect to Long Term Debt, Preferred Equity and Common Equity, Consumers' capital structure reflect the capital structure of its parent, CMS Energy and that the cost of Consumers' Common Equity should be based on CMS Energy's cost of equity. AG Initial Br, p. 21. This approach was rejected by the Commission in Case No. U-15645 and will not be adopted in this PFD. See *Application of Consumers Energy Co*, U-15645, Opinion and Order, pp. 16-17 (November 2, 2009).

### Common Equity

Consumers and Staff agree on a common equity balance of \$3,873,012,000.

This figure is accepted.

### Long-Term Debt and DOE Liability

Staff has projected a long-term debt balance of \$4,139,415,000, which includes projected DOE balance of \$163,124,000. Staff Initial Brief, pp. 9-10. Tr 4, p. 707. With the exception of the DOE balance, Consumers accepts Staff's projection. Consumers Initial Brief, p. 15.

As the Commission stated at *Application of Consumers Energy Co*, U-15645, Opinion and Order, p. 12 (November 2, 2009):

DOE liability represents Consumers' responsibility for the disposal costs of [spent nuclear fuel] associated with pre-1983 nuclear power generation at the Palisades Nuclear Power Plant (Palisades), which the utility has since sold. Pursuant to the Nuclear Waste Policy Act of 1982, which gave the federal government responsibility for disposing of SNF, the DOE began collecting a fee of 1 mill per kilowatt-hour (kWh) of nuclear power generation, on a going-forward basis, with a one-time charge assessed for previous generation. The DOE gave utilities three options to pay the fee for pre-1983 nuclear generation. Consumers opted to defer payment up to the time of disposal, subject to the accumulation of interest at the 13-week Treasury bill rate . . . .

Consumers argues that the DOE liability should be excluded from the cost of capital. Consumers Initial Brief, p. 38. As Consumers notes, in Case No. U-15645, the Commission assigned the full DOE Liability interest expense to electric ratepayers. Consumers argues that including the DOE Liability as long-term debt in the gas ratemaking capital structure is unfair to electric customers because they would be subsidizing gas customers. Consumers Initial Brief, pp. 38-39. Further, Consumers argues that it would be unfair to provide gas customers the benefit of the DOE liability,

as long-term debt, without having gas customers paying annual Letter of Credit (LOC) fees.<sup>2</sup> Consumers Initial Brief, p. 39. Consumers continues by arguing that the matter of segregating DOE liability to a trust fund will be addressed in Case No. U-16191 and that uncertainty about its availability provides additional reason to exclude DOE liability from this gas rate making case. Consumers Initial Brief, p. 39. Finally, Consumers takes the position that, if the Commission does not exclude the DOE Liability, it should include the Letter of Credit fees. Consumers Initial Brief, p. 40.

MCAAA, relying on the Commission's November 2, 2009, and January 25, 2010, orders in Case No U-15645, argues that, for calculating the cost of capital, zero costs should be applied to the DOE Liability. MCAAA Initial Brief, pp. 3-7. Further, MCAAA opposes recognition of LOC fees in rates and argues, at MCAAA, pp. 8-9:

(1) the ratepayers have already funded the DOE Liability, and should not now pay letter of credit costs to guarantee CEC's payment of ratepayer money that the ratepayer's already paid; (2) a letter of credit has no nexus to CEC retaining the DOE Liability, as DOE does not require letters of credit as a prerequisite to the utility retaining the DOE Liability; (3) the Commission has excluded these letter of credit fees in both U-14992 and U-15245, and CEC has presented no new grounds for a change in this precedent; and (4) the cost of the letter of credit fees is unreasonable.<sup>3</sup>

Finally, with regard to the DOE Liability, MCAAA recommends that the Commission establish a "MPSC regulated external interest-bearing trust to receive all of the funds comprising the DOE Liability". MCAAA Initial Brief, p. 10. MCAAA argues that, with an external trust, no Letter of Credit would be necessary and the funds would

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<sup>2</sup> The fees relate to a \$163 million letter of credit that allows Consumers to use the DOE liability funds and a \$30 million letter of credit related to Palisades power purchase obligations. These letters of credit are provided under a letter of credit facility obtained from the Bank of Nova Scotia. Until November 2009, the fees are 115 basis points per agreement, after which, it is expected the rate will rise to over 250 basis points. Tr 3, p. 175.

<sup>3</sup> MCAAA argues that the Letter of Credit fees are unreasonable because there is no chance that the DOE will commence spent nuclear waste disposal operations during the test year and, therefore, the Letter of Credit is valueless. MCAAA Initial Brief, p. 9.

be protected in case the DOE fails to accept spent nuclear fuel and other disposal methods become necessary. MCAAA Initial Brief, pp. 11-12.

Staff, likewise, takes issue with Consumers' position on the DOE Liability. Staff argues that Consumers "continues to retain the funds collected from ratepayers for the DOE liability, and as such, those funds should be appropriately reflected as a source of capital in the Company's capital structure. Staff has recognized the DOE liability balance in its long-term debt recommendation at a zero percent cost rate." Staff Initial Brief, p. 12. Staff also argues for exclusion of the DOE Liability Letter of Credit fees. As Staff sees it, the Commission has excluded these fees in Case Nos. U-15245 and U-15645 and nothing warrants reversal of those decisions. Staff Initial Brief, p. 12.

I find Staff's arguments convincing. In its November 2, 2009, order in Case No U-15645, the Commission determined that an expense item was needed in O&M to cover DOE interest cost. Additionally, it ordered Consumers to present, by January 4, 2011, a proposal to establish a DOE Liability trust. However, because, at this time, Consumers continues to retain the DOE Liability funds, they are appropriately included as a component of long-term debt. Furthermore, in accord with Commission policy, the LOC fees are appropriately excluded. Therefore, I accept Staff's projected long-term debt balance of \$4,139,415,000.

#### Short-Term Debt

Exhibit A-66 shows the projected monthly balances of short-term debt for the 2010 test year. In making these projections, Consumers considered the projected total monthly cash flow requirements, planned long-term debt, equity issuances, and accounts receivable financing. Tr 3, p. 170. Consumers and Staff agree on a short-

term debt balance of \$56,000,000. Staff Initial Brief, p. 10. Consumers Initial Brief, p. 16. This figure is accepted.

#### Other Capital Balances

Staff agrees with Consumers' recommended balances for Preferred Stock (\$44,000,000), Customer Deposits (\$32,000,000), Other Interest Bearing Accounts (\$35,000,000), Deferred Income Taxes (\$1,263,000,000), and Job Development Income Tax Credit (\$56,000,000). Staff Initial Brief, p. 10. Consumers Initial Brief, p. 16. Exh. A-60. These figures are adopted.

#### Cost Rates

Staff and Consumers agree on the following cost rates for: Preferred Stock (4.46%), Customer Deposits (7.00%), Other Interest Bearing Accounts (7.33%), Deferred Income Taxes (0.00%), and Job Development Income Tax Credit (8.50%). Areas of disagreement are limited to the rate of return on common equity, treatment of the Pollution Control Revenue Bonds (PCRB) fees in the long-term debt cost rate calculation, and treatment of the revolver fees and amortization in the short-term debt cost rate calculation.

#### Short-Term Debt

"Staff recommends a short-term debt cost rate of 1.94%, which consists of a 2010 forecasted 3-month LIBOR rate of 1.03%, 35 basis points or 0.35% for the revolver spread, plus 56 basis points or 0.56% in revolver fees for Consumers' two revolver credit facilities." Staff Initial Brief, p. 10. After considering the three month LIBOR cost, the revolver interest spread, and the commitment fees and amortization for

the revolving credit agreements, Consumers recommends that the short-term debt cost rate be set at 8.26%. Consumers Initial Brief, p. 35.

As Staff explains, at T44, p. 710:

The Company has access to two short-term credit revolving facilities, its more established \$500 million credit revolver and a newer \$150 million revolver obtained in 2008 (renewed in August 2009). The Company secured the second revolver during the height of the 2008-2009 U.S. financial crisis when short-term credit facilities were not only expensive but hard to come by since creditors offering short-term facilities were scarce. The Company obtained the second revolver primarily for security purposes in the event that additional liquidity would be required by the Company. Based on the Company's anticipated short-term debt expenditures in conjunction with its A/R financing vehicle, per Mr. Rao's exhibit A-66 (DVR-8), it appears that the Company's primary revolver will be sufficient to cover its short-term debt requirements in the 2010 test year.

Staff explains its methodology, at Tr 4, pp. 711-12, by stating:

Staff's short term debt cost rate takes into account the 2010 forecasted cost rate for 3-month LIBOR from Global Insight at 1.03%. Staff then adds in the Company's 35 basis point revolver spread and adds 10 basis points for the 1st revolver's commitment and amortization fees and 46 basis points for the 2nd revolver's commitment and amortization fees. This adds up to Staff's recommended 1.94% short-term debt cost rate.

Staff's cost rate takes into account the Company's commitment and amortization fees associated with each revolver and treats them separately. The cost is modified by a weighting factor representing each revolver's percentage to the entire revolver facility. Staff uses the cost rates provided by the Company in Mr. Rao's Exhibit A-64 (DVR-6).

\* \* \*

The 10 basis points associated with the 1st revolver consists of commitment fees on the unused balance of the 1st revolver, the fronting fees associated with the \$68 million letter of credit and 1st revolver amortization. The costs totaled \$610,000 using the Company provided cost figures on Mr. Rao's Exhibit A-64 (DVR-6). This amount was then divided by the \$500 million 1st revolver facility equating to 0.122%. The 1st revolver represents 77% of the Company's total revolver facility, so Staff multiplied the spread by 0.77 leaving approximately 0.10% or ten basis points added to Staff's overall short-term cost rate.

The 46 basis points associated with the 2nd revolver consists of fees for commitment and amortization totaling \$3 million. This amount is divided by the \$150 million total 2nd revolver facility resulting in 2%. Staff then applied the 2<sup>nd</sup> revolver's weighting of 23% to the spread amount resulting in 0.46% or 46 basis points added to Staff's overall ST-Debt cost rate. Staff's revolver fee treatment is highlighted on [Exhibit S-4] Schedule D-3, page 1 of 2.

As shown in Exhibit S-4, Schedule D-3, p. 1, in calculating the costs of Consumers \$500 million revolver, Staff removed 35 basis points from the cost of the LOC. In its Initial Brief, at p. 14, Staff argues:

The Company argues that its \$68 million letter of credit should be cost at 47.5 basis points, consisting of a 35 basis point credit spread and 12.5 basis points in up front and remarketing fees, instead of Staff's 12.5 basis point fee costing method. 3 TR 231. . . . In Staff's view, the Company has earmarked a portion of its existing revolver to provide the \$68 million letter of credit, therefore adding an additional 35 basis point credit spread fee for the letter of credit on top of the 35 basis point spread fee already taken into account in the revolver's cost is redundant and unreasonable. The Commission should reject the Company's arguments to cost the \$68 million letter of credit fee at 47.5 basis points (0.475%) and adopt Staff's 12.5 basis point fee (0.125%).

Consumers addresses Staff's treatment of the 35 basis point cost, in its testimony, by stating, at Tr 3, p. 231:

Consumers Energy is charged a fee of 35 basis points as a cost of obtaining the letter of credit in addition to the 12.5 basis point fee. The 35 basis point fee which was incurred in order to have the letter of credit in place is in addition to being charged a 35 basis point fee on drawn borrowings. Since the spread of 35 basis points is charged on both borrowings and in order to have the letter of credit available, the Company has included the 35 basis point letter of credit costs as a fee for the letter of credit in addition to a cost on the borrowed amount. Multiplying the \$68 million letter of credit amount by 47.5 basis points instead of 12.5 basis points will increase the cost of this portion of the fees for the \$68 million letter of credit amount from \$0.09 million to \$0.32 million, as shown on Exhibit A-84 (DVR-15).

Based on the testimonial evidence in the record, it appears that Consumers' inclusion of the 35 basis point in the cost of its LOC is proper.

Consumers takes additional exception to Staff's methodology in calculating the short-term debt cost rate. At Tr 3, pp. 231-33, Consumers witness, D. V. Roa testified, as follows:

Once the fee amounts have been determined, these need to be converted to a cost rate percentage. Staff divided the fees for each revolver by the total amount of each revolver. This method does not allow full recovery of the fees. The fees should be spread over the average borrowings.

\* \* \*

The cost rate impact for the projected fees for each of the letters of credit should be calculated by dividing the amount of fees by the average borrowing amounts rather than by the revolver amounts.

\* \* \*

With the exception of a disagreement regarding whether the 35 basis points should be included, the Staff and the Company are in agreement regarding the amount of fees . . . incurred in connection with the revolvers. The dollar amount of the fees that are calculated in note 1 and note 2 of Exhibit S-4, Scheduled D-3 and on Exhibit A-84 (DVR-15), are the dollar amount of the fees, in millions, that are incurred as a cost of having the two revolvers in place and available. These fees described in notes 1 and 2 on the exhibit are incurred in order to have the revolvers available, not based on the amount borrowed. In order to recover these fees, the fees must be allocated to the average outstanding balance as described above.

\* \* \*

Staff's use of a weighting methodology for recognizing the revolver fees is not appropriate.

\* \* \*

[Staff] calculates fees of \$3.61 million. Instead of recommending the 6.44% rate to recover the fees incurred for the revolvers, calculated above using the Staff fee amounts (\$3.61 million / \$56 million), [Staff] recommends a rate of 0.56% (0.10% + 0.46%). Multiplying \$56 million of average borrowing by the 0.56% rate . . . equals \$314,000. Using 0.56% . . . would result in recognizing only \$314,000 of a \$3.61 million cost in this case.

Mr. Roa recommends that fees totaling 6.88% be added to Staff's 1.38% calculation. This breaks down to 1.51% for the first revolver and 5.38% for the second and, per Mr. Roa, will allow recovery of \$3.84 million in revolver fees and interest.

Review of Staff's and Consumers' methodologies leads me to conclude Consumers' should be adopted. It appears that Staff's calculations do not provide Consumers the opportunity to cover the fees and interest associated with projected revolver borrowings. As testified to by Consumers' witness, Roa, Staff's methodology would result in recognizing only \$314,000 of a \$3.84 million cost. This result appears primarily due to Staff's methodology that divides costs by the limits of the revolvers rather than the average debt. Therefore, Consumers' short-term debt cost rate of 8.26% is adopted.<sup>4</sup>

#### Long-Term Debt

For the reasons explained below, I accept Staff's calculation of the Annual Cost Percentage for Long-term Debt, with the exception of an adjustment for an additional \$586,000 in PCRFB fees. Making this adjustment results in a long-term debt balance of \$4,139,415,000 and annual costs of \$243,073,000. The resultant cost percentage is 5.87%, slightly higher than Staff's projected 5.86% and lower than Consumers 6.07%. See Exh. A-28. See Exh. S-4, Schedule D-2.

With regard to PCRFB fees, Staff states its position, at Tr 4, p. 708-09:

Staff reduced [Consumers] requested \$611,000 in PCRFB fees to \$252,000. Consumers currently has a \$500 million revolving credit facility and the Company allocated \$103 million of that facility to a letter of credit requirement for its PCRFB debt. The Company priced its PCRFB letter of credit at 47.5 basis points, consisting of a 12.5 basis point fronting fee and a credit spread of 35 basis points. Staff already recognizes the Company's 35 basis point spread in its short-term debt cost rate which consists of the revolver used to provide the letter of credit. As such, Staff

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<sup>4</sup> I admit concern with the high cost of the Consumers' 2<sup>nd</sup> Revolver of \$150 million. Staff notes that Consumers "secured the second revolver during the height of the 2008-2009 U.S. financial crisis when short-term credit facilities were . . . expensive". It appears that the second revolver has never been used and that there are no plans for its use. Given its high cost and no plans for its use, I question the reasonableness of this expense. However, since no party has objected to its inclusion in the calculation of short term debt, I must conclude that all involved have examined this expense and found it reasonable.

priced the LOC at \$103M x 12.5 basis point fronting fee = \$128,750 and then added \$123,000 in fees based on . . . Company witness Rao's testimony as experienced costs, which, after rounding, equals \$252,000.

In rebuttal testimony, however, Consumers witness, Mr. Roa explained, at Tr 3, pp. 221-22, that:

Consumers . . . incurs certain on-going fees related to the [LOC] required to maintain the PCRБ debt securities. These fees include (i) ongoing bond remarketing expense and trustee expense, (ii) a fronting fee of 12.5 basis points, and (iii) a credit spread fee of 35 basis points. [Staff] included the first and second items, but did not include the third. . . . The fee associated with the 35 basis point spread is a cost which Consumers Energy must incur and should be included . . . .

\* \* \*

Consumers Energy appreciates that [Staff's] long-term debt cost rate treatment of the PCRБ fees is based on a sincere belief that the costs are included in the short-term debt calculation. However, [Staff] is mistaken in [its] belief that the costs are included in the short-term debt costs. No letters of credit balances related to the PCRБ amounts were included by Consumers Energy in determining the short-term debt cost rate shown on Exhibit A-64 (DVR-6). This is noted at the bottom of pages 1 and 2 of Exhibit A-64 (DVR-6) in footnote a. The fee for the PCRБ amounts was not included. [Staff] is correct that the revolver was used to provide the letters of credit. However, [Consumers] only included the cost under long-term debt as PCRБ fees, since this cost is directly tied to our PCRБ debt. The costs of the letters of credit used for the PCRБ debt were not included in the Company's short-term debt cost. The same conclusion is applicable to the Staff short-term debt calculation.

\* \* \*

The Company did not include the PCRБ letters of credit in the \$56 million of short-term borrowings or the \$68 million of letters of credit used to calculate short-term debt costs in Exhibit A-64 (DVR-6). . . . Staff has recommended a short-term debt balance of \$56 million, consistent with Consumers recommended balance. Staff has also used the \$68 million amount in its calculation of short-term debt revolver costs. Consequently, the same conclusion is applicable to the Staff short-term debt calculation.

\* \* \*

[Consumers recommends] that the amount included for the PCRБ fees in the calculation of the ratemaking long-term debt annual cost rate be increased to \$611,000.

Based on Mr. Roa's testimony it appears the no PCRБ fees were included in the calculation of the short-term debt cost rate. Thus, these fees should be accounted for in long-term debt. I accept Consumers calculation of \$611,000 as the cost for the PCRБ fees.

### DOE

For reasons stated above, the DOE Liability funds are included in long-term debt at zero cost.

### Common Equity

Consumers argues for a return on common equity of 11.00%. Staff argues for 10.70%. For the reasons stated below, I find reasonable and adopt a figure of 10.45%.

To establish a cost of equity range for Consumers, Staff used a proxy group of twelve comparable publicly traded natural gas companies. For inclusion in the proxy group, Staff required that each company have the following characteristics: net plant in excess of \$650 million; that they derive no less than 40% of their revenues from natural gas service; have a minimum investment grade rating of BBB- or Baa3 from the two primary rating agencies Standard & Poor's and Moody's; currently be paying dividends to shareholders, and; could not be involved in a major merger, acquisition or buyout. Staff's recommendation was made after analysis using a Discounted Cash Flow Model (DCF), a Capital Asset Pricing Model, a Risk Premium Method, and a review of returns on equity authorized by other state regulatory commissions. Staff Initial Brief, p. 16. As explained in Staff's Initial Brief, at pp. 17-18:

The DCF model derives its basis by surmising how investors evaluate stocks for potential investment. The formula assesses that investors value securities by 'discounting' to the present the expected future cash flows attributed to those securities, which include dividends, a

capitalization rate investors apply to future cash flows and the projected sale of the securities at liquidation. Staff obtained the data for its DCF analysis using statistics from its proxy group and growth estimates from industry analysts. Staff's DCF analysis produced a cost of equity estimate of 9.82%. 4 Tr 721-723.

\* \* \*

The CAPM model suggests that an investor has a full investment portfolio, and thus an investor's required return is a function of the investor's exposure to risk that cannot be diversified away, i.e., systemic risk as opposed to firm specific or diversifiable risk. Therefore, the risk of an asset and thus the investor's required return is a function of the risk that the asset contributes to the market. This risk is characterized by the beta coefficient. Hence, in order to estimate a cost of equity using the CAPM model in this case, one needs a riskless or risk free rate, an estimate of beta for the proxy group, and a market return for a wide portfolio of assets. 4 Tr 724.

For the risk free rate, Staff used an average 2010 forecasted 30-year Treasury bond yield estimate of 4.68%. Staff used the proxy group's average 0.77 beta estimate, and a 1926 – 2008 market return of 6.47% and a 1958 – 2008 market return of 5.48%. Staff computed a CAPM cost of equity estimate of 9.66% for the 82-year period and 8.66% for the 50-year period. The results are in the lower end of average ROE estimates due primarily to the moderate risk-free rate estimate and the proxy group's moderate beta estimate. 4 Tr 725-726.

\* \* \*

The risk premium method examines the spread between historical gas utility realized stock returns and historical composite utility bond yields, and develops a cost of equity estimate by incorporating the historical data with current utility data. Staff used a combination of historical gas utility market returns and average S&P and Dow Jones utility index returns, along with bond spread premiums for A/A2 through BBB-/Baa3 rated utilities to derive a cost of equity estimate using the risk premium method in this case. Staff's risk premium ROE estimates averaged 12.58%. 4 Tr 726-727.

\* \* \*

Staff reviewed other natural gas utility ROE recommendations rendered by other State Commissions from 2004 through 2009. The average authorized ROE from those decisions was 10.40%. 4 Tr 728.

Staff explains its recommendation, at Tr 4, p. 728, by stating:

Based on the average DCF cost of equity estimate of 9.76% for the gas proxy group, the average CAPM equity cost of 9.28%, the average risk premium cost of 12.58% and taking into consideration the average authorized ROE of 10.40% from other natural gas Commission decisions

as a check of reasonableness, it is Staff's judgment that a cost of equity recommendation for Consumers Energy falls within the range of 10.45% - 10.95%, as highlighted in Exhibit S-4, Schedule D-5, page 12. Staff recommends the cost of equity midpoint 10.70% . . . .

Consumers engaged in similar analysis to formulate a projected rate of return, as explained at Consumers Initial Brief, p. 21.

Consumers Energy's witness Mr. Rao applied multiple modeling methods to a group of proxy companies in determining an appropriate rate of return for Consumers Energy's gas business. 3 TR 186-197. Mr. Rao's analyses included: (i) the Capital Asset Pricing Model ("CAPM") (discussed at 3 TR 188-193), (ii) the Risk Premium methodology (discussed at 3 TR 193), (iii) the Discounted Cash Flow ("DCF") methodology (discussed at 3 TR 193-197) and (iv) the Value Line Book Value ROE methodology (discussed at 3 TR 197). 3 TR 184. The results of these analyses are summarized on page 10 of Exhibit A-68 (DVR-10). Mr. Rao also undertook multiple assessments of risk.

Like Staff, Consumers also selected a proxy group. Consumers' witness, Rao, started by use of the Value Line Investment Survey to identify publically traded gas utility companies. This group was trimmed to nine utilities by limiting it to only those companies that were paying current common stock dividends, have bonds rated at or above a minimum investment grade of Baa3 by Moody's Investor Services and BBB- by Standard & Poor's, and have approximately 40% or more of its operating revenues from gas operations. Tr 3, p. 187. See Exh. A-68.

Because of the recent economic turmoil, Consumers' performed CAPM analyses using both historic risk premium and prospective risk premium and the results are summarized in Exhibit A-68, page 3 of 10. Historic risk premium results for the proxy group ranged from 7.69% to 8.66%, averaged 8.12%, and have a median value of 8.01%. The prospective risk premium results ranges from 9.21% to 10.56%, average 9.81% and have a median value is 9.66%. Consumers also performed CAPM analysis

on CMS Energy which resulted in a 9.31% return for historic results and an 11.46% return under the prospective risk premium approach. Tr 3, p. 192.

Consumers' risk premium analysis examined the risk premiums of gas utility common stocks over the yield on utility bonds. Consumers' results averaged 11.68% for the proxy group and 12.01% for Consumers. See Exh. A-68, p. 7. Tr 3, p. 193.

Consumers Discounted Cash Flow Model is summarized in Exhibit A-68, p. 8. Returns range from 9.78% to 12.23% and average 10.63% for the proxy group. The proxy group's median return is 10.47%. Consumers' result for CMS Energy is 12.61%. Tr 3, pp. 196-97. See Exh. A-68.

Finally, Consumers used the Value Line Book Value method to project earned ROE for the proxy group. Under this method, projected earnings per share are divided by the projected book value per share to calculate a projected return on equity. A summary of the results are found at Exhibit A-68, p. 9. The average result for the proxy group is 11.74% and the median is 11.31%. Tr 3, p. 197. Exh. A-68, p. 9.

As shown in Exhibit A-68, p. 10 and explained at Tr 3, p. 205:

In determining a ROE recommendation, [Mr. Roa] reviewed the average and median results from the CAPM, Risk Premium, DCF analyses, and Value Line Book Value ROE methods described above. [He] then adjusted those results to reflect the additional risk of Consumers Energy as measured by differences in credit ratings of Consumers Energy as compared to the average credit ratings of the proxy group. . . . The average and median results for the proxy companies are listed in the first five lines of page 10 of Exhibit A-68 (DVR-10). These results are adjusted for the additional risk of Consumers Energy on lines 7 – 11. The adjustment for the corporate bond spread differential that is used in the adjustment is shown on line 6<sup>5</sup>. . . . Based on the results and on . . . professional judgment, [Mr. Roa] recommend[s] a range for Consumers Energy's gas business in this case of 10.75% to 11.25% and that a return

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<sup>5</sup> Consumers calculated a differential of 0.34% which is equal to the 30 year bond spread differential between the A/A3 average proxy group rating and the BBB/Baa1 rating of Consumers. Since making this calculation, Moody's has upgraded Consumers' rating which changes the spread differential.

on equity for Consumers Energy's gas business be set at not less than 11.00%.

Attorney General witness, Sebastian Coppola, testified to the Attorney General's position that the capital structure for Consumers should reflect the capital structure of its parent, CMS Energy, with respect to long-term debt, preferred equity and common equity. Mr. Coppola recommends adoption of a cost of common equity for Consumers based on the cost of equity for CMS Energy. Tr 6, p. 1150. Additionally, at Tr 6, p. 1159:

To determine the cost of common equity, [he] . . . utilized three approaches to assess this cost. These are the Discounted Cash Flow (DCF) Method, the Capital Asset Pricing Model (CAPM) and a Risk Premium approach. Also, [he] considered the continuing recovery in the Capital Markets and potential changes in the risk profile of CMS Energy as a result of changes occurring in CEC's natural gas business.

In addition, [he] considered the cost of common equity for the same proxy group of peer companies considered by Company witness Rao. The results of this proxy group are recommended for consideration by the Commission in the event that the decision in this case is based on the capital structure of CEC only.

The Attorney General's DCF analysis, using Consumers' proxy group, updated with more current stock price information, resulted in rate of return for the proxy group of 10.21% and for CMS Energy of 11.85%. Tr 6, p. 1160. Exh. AG-14. See Exh. A-68.

Exhibit AG-15 summarizes the Attorney General's results for analysis under the CAPM method. Using a historical market risk premium resulted in an average return on common equity of 8.12% for the proxy group and 9.13% for CMS Energy. In addition, the Attorney General engaged in separate CAPM analysis for proxy sub-groups divided on the basis of RDM utilization. As explained at Tr 6. pp. 1162-63:

The first group [of] companies . . . conduct the majority of their businesses in jurisdictions with minimal or no Revenue Decoupling mechanisms. The average CAPM results for this group indicate that the

cost of Common Equity for this Group 1 is 8.42%. The second group of companies . . . benefit from Revenue Decoupling mechanisms, Weather Normalization mechanisms or in the case of WGL Holdings have acquired weather protection through insurance or derivatives. The CAPM results for this group indicate that the cost of Common Equity is 7.89% which is 0.53% less than the return for the first group which does not benefit from Revenue Decoupling in any meaningful way.

Mr. Coppola rejects Consumers' CAPM results based on prospective market risk.

In particular, he criticizes Consumers' reliance upon recommendations from an outdated report, by stating, at Tr 6, 1163-64:

I have reviewed this report which was produced at a time when the U.S. Capital markets were under significant stress and investors were seeking less risky investments. Since the time of the report, the U.S. Capital markets have stabilized. U. S. equity prices are up approximately 30% and the yield on intermediate and long term U. S. government debt has increased by approximately 0.50%. A key conclusion regarding the Market Risk Premium (MRP) of the above mentioned J. P. Morgan report was that " . . . we estimate the MRP to fall within a range of 8 – 10% today [emphasis added]." Since the report underlying the "Prospective Risk Premium" approach of Company Witness Rao relates only to a moment in time in the past during extreme conditions in the capital markets—which is no longer relevant—I cannot support this approach and advocate that the Commission reject it as well. The appropriate CAPM results that should be considered in this case should be based on a "Historic Risk Premium" basis.

Exhibit AG-16 summarizes the Attorney General's risk premium analysis that resulted in a rate of 8.97%. Mr. Coppola used the same historical spread and risk free rate used by Consumers. However, for the differential between "A" rated gas utility bonds and U.S. Government bonds, Mr. Coppola used a 10-year time series ending in December 2008. A 0.34% upward adjustment was made to compensate for Consumers' lower bond rating. Tr 6, p. 1165.

Mr. Coppola criticizes Consumers' methodology for determining the spread between "A" rated utility bonds and U.S. Government bonds. The different

methodologies are largely responsible for Consumers' and the Attorney General's differing results. Consumers used bond spreads from the November 2008 to March 2009 period. Tr 6, p.1166. See A-68, p. 6. As stated by Mr. Coppola at Tr 6, p. 1166:

[T]his limited time period was one of extreme stress in the financial markets. Recognizing that the U.S. economy was in a deep recession, investors during this time frame fled to less risky assets thereby driving down yields on U.S. government securities and driving up yields on more risky assets. As a result, yield spreads during this time frame increased significantly. My approach to determining the spread between the risk free rate and "A" rated gas utility bonds was to consider the last ten years of yields on these securities. The capital markets have resumed more normal conditions in the last six months. As such, the Commission should give no weight to witness Rao's Prospective Risk Premium approach in estimating the cost of Common Equity.

The Attorney General is additionally recommending a reduction in the return on equity should the Commission approve a revenue decoupling mechanism and the true-up mechanisms proposed by Consumers. As testified to by Mr. Coppola, at Tr 6. p. 1166-67:

A Revenue Decoupling Mechanism for CMS Energy's gas utility business will reduce the Company's risk significantly. . . . [Consumers] reported that . . . from 1999 to 2008, it failed to realize approximately \$289 million of gross profit from revenue levels set in rates due to energy conservation by customers and other load losses excluding the impact of weather. This is an average of nearly \$29 million per year of lost gross margin, or approximately \$17.7 million of net income after taxes. Exhibit AG-17 calculates that the loss of this annual net income represents a -1.49% lower return on equity based on the pro-forma common equity capital of CECO's gas division. Therefore, the RDM proposed by the Company will be a significant benefit to the Company to shield it from lost profits. Exhibit AG-18 shows the impact of weather on the earnings of the Company over the past 10 years. The impact on after tax average annual earnings is estimated to be an additional loss of \$3.7 million or -.31% on return on equity capital.

In light of the above calculations, the Attorney General recommends a return on common equity of 10.09. This figure includes a downward adjustment to account for the presumed adoption of a RDM. See Exh. AG-13. Should the RDM include weather

normalization, the Attorney General recommends a return of 9.99%. Inclusion of an Uncollectible True-up Mechanism results in additional recommended reductions of .15% and, for Pension and Other Post Retirement Benefit Cost true-up mechanism, a reduction of .10%. AG Initial Brief, pp. 29-30.

ABATE states its position regarding the rate of return on common equity by stating, at ABATE Initial Brief, p. 17:

Mr. Coppola supports a return on equity of 10.09%, and ABATE agrees. As noted by Mr. Coppola, this recommended rate of return on common equity assumes that the Commission does not approve the automatic adjustment clauses requested by Consumers for uncollectible costs, pension costs and post-retirement benefit costs. 6 T. 1156. Mr. Coppola performed a DCF analysis (Exhibit AG-14), a CAP-M analysis (Exhibit AG-15), and a Risk Premium analysis (Exhibit AG-16). These analyses support Mr. Coppola's recommendation of 10.09% earned return on invested equity.

ABATE also agrees with Mr. Coppola that if the Commission approves a revenue decoupling automatic adjustment clause, that this will reduce Consumers' business risk. Mr. Coppola recommends that the earned return be reduced by between 40 and 50 basis points. 6 T. 1166-1167. ABATE supports a reduction in the earned rate of return of 50 basis points should the Commission approve a revenue decoupling automatic adjustment clause for Consumers.

I am not convinced by Consumers' arguments. First, it appears that the 0.34% adjustment for risk is based, in part, on outdated Moody's bond ratings. See Exh. A-68, p. 1. Additionally, I agree with the Attorney General's criticism of Consumers' prospective market risk CAPM analysis. I note that, a review of Consumers' proxy group risk adjusted results, found at Exh. A-68, p. 10, reveals that the average median result is approximately 10.20% and the average of the average results is 10.73%. None-the-less, Consumers recommends an 11.0% return on equity. I find this recommendation unreasonable.

I am not persuaded by the Attorney General's argument to adopt CMS Energy's capital structure and note its rejection by the Commission in its November 2, 2009, order in Case No. U-15645. However, I do find the Attorney General's criticisms of Consumers' methodologies legitimate. I, also, accept the Attorney General's argument that adoption of the RDM and other equalization mechanism reduces Consumers' risk and should be reflected in the ROE.

I find the various models used and results obtained, by Staff, to be, generally, reasonable. However, I do not feel that the results support Staff's recommendation that the return on equity be raised to 10.70%. Staff believes its findings support a recommended rate of return range of 10.45% - 10.95% and Staff selects the midpoint of 10.70% which is higher than the 10.55% return on equity that the Commission approved in Case No. U-15506. I find nothing in the record sufficient to justify this increased return on equity. I note that the average of the results for Staff's various models equals 10.51%. See Exh. S-4, Schedule D-5, p. 12. Staff's review of other regulatory agencies revealed that the average approved return on equity was 10.40%.

Based on Staff's results, accounting for decreased risk associated with an RDM, and after, otherwise, considering the evidence presented and the arguments made, I adopt 10.45% as a more appropriate ROE. This figure is at the low end of Staff's range, yet still above the average return on equity approved by other State regulatory agencies. Presuming approval of the RDM, I consider this figure more than generous to Consumers. This figure does not account for any decreased risk associated with adoption of any of the other equalization mechanism. Should any of the other

mechanisms be approved, I recommend reductions to the ROE in accord with the Attorney General's recommendations.

### Summary

For the reasons stated above, I recommend a return on common equity of 10.45% and an overall rate of return of 6.99%. See Appendix E.

### **THROUGHPUT**

For the 2010 test year, Staff agrees with Consumers' forecasted number of customers and sales volumes and with Consumers' use of 15 years of historical data for weather normalization. Tr 4, p. 756. The Attorney General objects to the use of only 15 years of historical data and projects higher throughput.

The Attorney General argues that the purpose of weather normalization is to eliminate variability and not to predict weather during the future. AG Initial Brief, p. 7. While acknowledging that there has been a warming trend in recent years, the Attorney General notes that, in any single year temperatures can fluctuate significantly. AG Initial Brief, p. 7. In part, the Attorney General favors the 30-year methodology because it would reduce revenue deficiency by \$5,732,000. AG Initial Brief, p. 8.

I do not find the Attorney General's arguments convincing. It appears clear that weather normalization using 15 years of data produces results more reflective of current warming weather trends. Therefore, I accept Consumers' and Staff's weather normalization using only 15 years of data.

Exhibit A-12 shows Consumers projected deliveries by customer class for the test year and are "based primarily on regression analyses". Tr 3, p. 346. "The normal

level of heating degree days used to forecast gas deliveries . . . was developed by taking an average of the most recent 15 years (1994 – 2008) of historical heating degree days.” Tr 3, p. 348. Consumers selected use of a 15-year period, rather than a 30-year period, because the 15-year period has, in recent years, been a more accurate predictor of future normal weather. Tr 3, p. 348.

Customers’ forecasts, by class, are shown on Exhibit A-12 (LJC-3) and described, at Tr 3, p. 352-53:

For the space heating category, a forecast of average consumption was based upon an annual regression model from 1997 through 2008 using heating degree-days, Michigan single family housing starts, and Michigan average household size as the independent variables. The customer forecast for this category was based upon an exponential smoothing model. The residential space heating gas deliveries forecast is the product of the average consumption and customer forecasts.

For residential domestic and multi-family customers, the forecasts were also developed through the use of exponential smoothing models. Regression analysis was used to forecast domestic and multi-family average consumption.

\* \* \*

For the commercial category, a forecast of deliveries was based upon an annual regression model from 2001 through 2008 using heating degree days, Michigan population, and Michigan unemployment percent as the independent variables.

\* \* \*

The gas deliveries forecasts for the General Motors class was based upon an annual regression model from 2002 through 2008 using Michigan transportation equipment employment, the Michigan industrial production index, and Michigan unemployment percent as the independent variables. The forecast for the Industrial Other (industrial deliveries excluding deliveries to GM, Dow, and Detroit Edison) class was based upon an annual regression model from 2002 through 2008 using the Michigan unemployment percent and heating degree days as independent variables. The gas sales forecast to Dow Chemical was developed using an exponential smoothing model. Professional judgment was used to develop the forecast of Detroit Edison gas sales.

\* \* \*

The interdepartmental category represents gas used by Consumers Energy in areas not related to the gas business. Interdepartmental

deliveries are projected to remain at a level similar to recent history, based on professional judgment.

Consumers' witness, Linda Clark, testified about Consumers' projected number of customers for the test year. The exponential smoothing models she used place "more weight at the end of the forecast period". Tr 3, p. 370. Additionally, after running the models, Ms. Clark, using her professional judgment, "adjusted" the results by an amount that she could not recall. Tr 3, p. 373. Ms. Clark acknowledged that, her predictions were made "rather difficult" by having "a new [computer] system in place". Tr 3, p. 370.

Recent historical data shows increasing customer numbers for 2004-2006. Tr 3, p. 368. For 2007-2008, residential customers dropped by about 2400. Tr 3, p. 368. Commercial and Industrial were down about 60 customers for 2007-2008. Tr 3, p. 368. For the 2010 test year, Ms. Clark has projected a decrease in residential customers of 22,737, commercial by 1013, and Industrial by 305. Exh. A-15.

For the 2010 test year, Consumers forecasts deliveries of 271.6 Bcf; down 25.7 Bcf from the weather normalized 2008 deliveries. Tr 3, p. 355.

The Attorney General disputes Consumers' calculations. To calculate residential gas usage, the Attorney General started with Consumers' 2008 average number of customers and Consumers' 2008 average use per customer. To arrive at 2010 projections, the average, per customer, use was reduced by the historical usage declines identified by Consumers. Tr 6, p. 1132. A like procedure was used to calculate average Commercial consumption. Tr 6, p. 1132. Industrial use was calculated to shrink in relation to the drop in the Michigan Real Product index. Tr 6, p. 1132.

To arrive at the projected number of customers, the Attorney General started with Consumers' calculated average number of customers for 2008 and reduced that by the "rate of decline in the Michigan population for the period 2008-2010 and prorated it for the period January 2009 to September 2010." Tr 6, p. 1133. The same process was used for calculation of decline in Commercial customers. For Industrial customers, a factor to account for higher unemployment figures was added.

With regard to throughput, except for Residential, nothing in the record seriously challenges Consumers' projections. Admittedly, the Attorney General presents a reasonable alternative method for making these projections. However, based on the record, I am not persuaded that the Attorney General's calculations for Commercial and Industrial customers are likely to produce more accurate predictions. However, for Residential, I come to a different conclusion.

I find little reliability in Consumers' residential projections. First, as admitted, the exponential smoothing model places greater weight on the most recent years. Because of this, "recent declines are amplified and can lead to [a] grossly exaggerated forecast". Tr 6, p. 1129. Further, Ms. Clark admits that she found her predictions rather difficult to make because of a change in computer systems. More concerning, however, is her inability to quantify the "adjustments" she made to her model's results. Tr 3, p. 370. In short, based on this record, there is no way to determine the precise method she used to estimate an unusually large decrease of 22,737 residential customers for the 2010 test year and the credibility of this estimate is severally undermined.

Therefore, for the number of residential sales customers, I accept the Attorney General's projections of a decrease of 9,466. This results in addition of 13,271

customers to that projected by Consumers. With an average usage of approximately 102.36 Bcf, a reasonable projection results in additional sales of 1,358,419.56 Mcf and revenues of \$4,550,706<sup>6</sup> over that projected by Consumers.

### **ADJUSTED NET OPERATING INCOME**

#### **Operating Revenues**

Consumers projects operating revenues of \$2,448,032,000. Consumers Initial Brief, Appendix C, p. 1. As outlined below, I recommend total operating revenues of \$2,462,967,799.

#### **Sales Revenues**

Consumers calculated sales revenue of \$2,325,129,000 and Staff calculated sales revenue of \$2,325,141,000. Consumers accepts Staff's projection. Consumers Initial Brief, p. 45. For the reasons, stated above, I feel the Attorney General's projected number of residential customers should be adopted and Consumers projected revenue should be adjusted upward by \$13,180,348.00 to \$2,338,310,348.

#### **Transportation Revenues**

Consumers and Staff agree to projected transportation revenues of \$33,169,000. The Attorney General projects significantly higher Industrial revenues. See Exh. AG-8. However, I can not find the Attorney General's methodology sufficiently preferable to warrant adjustment of the figure agreed upon by Staff and Consumers.

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<sup>6</sup>  $159,175,000 \text{ (WP-LJC-5, line 10)} / 1,555,126 \text{ (WP-LJC-2, line 12)} = 102.36 \text{ Mcf (avg. use, Residential)}$   
 $1,568,397 \text{ (WP-LJC-2, line 12)} - 1,555,126 \text{ (AG-7, line 1)} = 13,271 \text{ (Additional customers over Consumers' projection)}$   
 $102.36 \times 13,271 = 1,358,419.56 \text{ (Additional sales over Consumers projection)}$   
 $1,358,419.56 \times (\$3.35 \text{ (AG-3, line 6)} + 7.528) = \$4,550,705.53 \text{ (Additional revenue over Consumers projection)}$

### Miscellaneous Revenues

Consumers estimates miscellaneous revenues at \$89,650,000 for the September 2010 test year. Exh. A-8, schedule C-4. Staff accepts Consumers' projected miscellaneous revenue, with adjustments. First, Staff adds \$72,000 that it attributes to a rounding error. I accept this adjustment. The other adjustments relate to projected Buy/Sell and Asset Management Agreements (AMA)<sup>7</sup>. For the reasons stated below, these Staff suggested adjustments are accepted. With those modifications, I adopt \$91,488,451 as miscellaneous revenue for the September 2010 test year.

The 2009 revenues for Buy/Sell and AMA is approximately \$13,740,000. To project 2010 test year revenues, Staff proposes use of the three-year, 2007-09, average of these revenues. Staff Initial Brief, p. 22. The three-year average for these items is \$12,109,702. Tr 3, p. 318. Consumers' proposes use of the 2003-09 average of \$10,343,251. Consumers Initial Brief, p. 48. The longer time frame used by Consumers, incorporates price volatility associated with hurricanes Katrina and Rita and earlier years with significantly lower revenues. I find Staff's methodology preferable and accept their projection of \$12,109,702.

### Operating Expenses

#### Cost of Gas Sold

Consumers accepts Staff's projected cost of gas sold of \$1,681,793,000. This figure is adjusted upward by \$10,226,182 to \$1,692,019,182 to account for additional residential sales, identified above.

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<sup>7</sup> For a concise description of these transactions, see Consumers Initial Brief, pp. 45-46.

### Company Use and Lost and Unaccounted for Gas

Exhibit A-32 summarizes Consumers calculation of Company Use and Lost and Unaccounted for Gas (LAUF). Staff agrees with Consumers' calculations of total deliveries of 271,575,000 Mcf, an LAUF percentage of 1.0844, a gas-in-kind percentage of 1.86, and total costs of \$29,725,913. Staff Initial Brief, p 21. To account for higher throughput, Staff and Consumers' projected total is adjusted upward, by \$229,075<sup>8</sup>, to \$29,954,988.

### Other Operations & Maintenance Expenses (Other O&M)

Consumers projects 2010 Other O&M at \$384,134,000. Consumers Initial Brief, p. 51. Consumers began by calculating 2008 normalized Other O&M of \$353,241,000. Exh. A-3. Exh. A-27. Consumers Initial Brief, p. 51. Consumers made adjustments, found in Appendix D of its Initial Brief, to reach a final projection of \$384,134,000. Consumers Initial Brief, p. 51.

Staff recommends projected Other O&M expenses of \$356,818,780 for the September 2010 test year. Staff Initial Brief, p. 22. To reach this projection, Staff made historical and projected adjustments to the 2008 Other O&M amount of \$353,240,131. Staff Initial Brief, p. 22.

To arrive at the projected Other O&M for the September 2010 test year, Consumers and Staff agree on the following disallowances from the 2008 historical Other O&M: Supplemental Executive Retirement Plan (SERP), \$1,284,000; Employee Incentive Separation Plan (EISP) \$13,000; Restricted Stock plans, 2,489,000; Advertising, \$29,000; Corporate Communications \$38,000; Dues, \$21,000; Lobbying, \$21,000; Corporate Giving, \$210,000; Chamber of Commerce Expense, \$54,000, and;

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<sup>8</sup>  $(1,636,009 \times .01860)7.528 = 229,075$

Katz Litigation Settlement Expense, \$736,000. Staff Initial Brief, p. 25. As discussed below, Staff and Consumers disagree on the proper treatment of Consumers' Employee Incentive Compensations plans.

Staff and Consumers are, to a large degree, in agreement on the projected adjustments to be made to the 2008 test year. Disagreements are largely limited to Corporate, Corporate-uncollectibles, and Accounts Receivables Sales Costs.

The Attorney General argues for a freeze on Gas Division O & M expenses at their 2008 level to "send a clear signal to [Consumers] that it must find ways to reduce its cost structure." AG Initial Brief, p. 15. For the reasons cited by Consumers in its Reply Brief, at pages 32-34, the Attorney General's argument is not accepted.

For reasons stated below, I accept Consumers' 2008 Adjusted Historical O & M, in the amount of \$345,639,000 and project \$374,001,813 for Other O&M for the September 2010 test year. (See Attachment A)

#### Officer and Non-Officer Employee Incentive Compensation (EICP)

Staff recommends disallowance of \$4,383,127 from the 2008 test year. Staff Initial Brief, p. 23. Based on prior holdings of the Commission, Staff finds two specific reasons for exclusion of these expenses. "First, it is the Commission's well-established policy that utilities must provide quantitative evidence that its EICP plan benefits are commensurate with costs, but the Company did not provide any quantitative support. Second, the Company has not shown how its incentive payments correlate to individual employee achievement." Staff Initial Brief, p. 24.

Consumers does not contest the complete exclusion of officer EICP. However, Consumers argues for inclusion of approximately \$1.7 million of the \$3.4 million that Staff characterizes as non-officer EICP. Consumers states, at Tr 3, p. 111:

[Staff] incorrectly characterizes this expense as being 100% attributable to [Consumers'] non-officer . . . EICP. Only half of this amount is attributable to the non-officer EICP compensation. The balance is part of the non-officer base salary expense. Mr. Welke's disallowance is not appropriate. Regardless of how the EICP portion of compensation is handled for ratemaking purposes, the base compensation portion of the expense should be included in determining the revenue requirements in this case. There is no valid basis to disallow any portion of non-officer base salary compensation.

In 2009, Consumers' management changed its non-officer EICP to incorporate "additional goals, higher standards, and more stringent evaluation criteria". Tr 3, p. 112. In conjunction with making the standards for receipt of incentive pay more challenging, Consumers reduced the total amount of incentive pay by 50%. Tr 3, p. 112-13. The \$1.7 million that had previously been assigned to EICP, under the less challenging criteria, has been assigned to base pay.

Consumers feels it appropriate to include this \$1.7 million expense because: it is part of employee base salary; base salary compensation is below the market-based compensation level; without this base salary adjustment, base compensation would be further below competitive compensation levels, and, by including the base salary adjustment and the EICP, non-officer compensation is at a competitive level. Tr 3, pp. 115-117.

I find Consumers' argument convincing. No evidence has been presented to rebut Consumers' position that non-officer base salary is below competitive levels and

this argument is accepted. Thus, the \$1.7 million expense that was transferred out of the new, more stringent, EICP and into base salaries should not be excluded.

#### Gas Uncollectible Expense

Consumers is projecting a \$34.87 million uncollectible expense for the test year ending September 2010. Consumers Initial Brief, p. 51.

Uncollectible expense is made up of two components. The first component is the writeoff of customer accounts receivable balances that are deemed uncollectible. The second component reflects changes during the period in the uncollectible reserve account. The balance in the uncollectible reserve represents the estimate of existing receivables that will not be collected in the future and is recorded as an offset to the carrying value of accounts receivable. A change in the reserve account increases or decreases uncollectible expense. Together, the two components represent the estimate of the current period impact on the Company's income from customer accounts that will not be collected.

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[P]ast practice [to project uncollectibles] has use[d] a three-year average Bad Debt Loss Ratio (BDLR) for uncollectible write-offs and also excluded the change in the uncollectible reserve. Tr 4, p. 579.

Because uncollectible expenses have increased each year of the most recent three years available for averaging and because the Michigan economy has deteriorated, Consumers proposes to abandon use of the three-year average. Instead, Consumers started by forecasting an uncollectible write-off expense for 2009 that represents a 30% increase over 2008. "Because unemployment is predicted to remain at levels similar to 2009 through the end of 2010, the Company applied the BDLR for the 2009 forecast to arrive at the projected uncollectible write-off expense for the 12-months ending September 2010." Tr 4, p. 581.

"Staff projects the September 2010 uncollectible expense at \$18,175,331, assuming no tracker. This expense was calculated by using a three years average of

net uncollectible expenses for 2006 through 2008 as a percentage of total revenues for the same years. The uncollectible factor of .7707% was applied to 2010 Total Sales and Transportation Revenue”. Tr 4, p. 779. Staff finds this established procedure preferable because, as Staff sees it, Consumers “chose to use a single-year uncollectible expense adjusted for projected increases even though it knew that its 2008 uncollectible expenses were exaggerated when compared to recent historical levels”. Staff Initial Brief, p. 27.

As Staff notes, the Commission has previously approved the three-year averaging method for the calculation of uncollectible expenses, by stating:

The Commission . . . finds that . . . Staff’s method for calculating uncollectibles expenses, by using a three-year average, is reasonable. Consumers’ evidence . . . shows that uncollectible expenses can be extremely unpredictable, and the Commission has traditionally used an averaging method for volatile items. Although the Commission has typically used a five-year average for uncollectible expense, . . . Staff departed from this method in order to better reflect current economic conditions. . . . Staff determined that the first two years of the traditional five-year average for uncollectible expense were not representative of current economic conditions . . . . Therefore, . . . Staff excluded those years from its average. *Application of Consumers Energy Co*, U-14347, Opinion and Order, p. 52 (Dec 22, 2005).

The observations and rationales used by the Commission in Case No. U-14347 are sufficiently applicable to this matter to warrant a like outcome. Therefore, I adopt Staff’s use of three-year averaging to project 2010 uncollectibles. However, due to the higher throughput for Residential customers, discussed above, I have adjusted Staff’s projected uncollectible expense upward, by \$41,684<sup>9</sup>, to \$18,217,015. This results in a downward adjustment of the historic O&M of \$8,465,316 for the projected test year.

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<sup>9</sup> .007707 x \$5,408,630 = \$41,684

### Standardized Retirement Unit (SRU) Impact

Staff recommends that the Commission incorporate the same SRUs that it adopted in Case No. U-15629, that is: a/c # 367- Transmission Mains: 50 linear feet; a/c # 376-Distribution Mains: 50 linear feet; a/c # 380-Services: one service line, main to meter. Staff Initial Brief, p. 36. In rebuttal, Consumers' witnesses Jan C. Anderson, at Tr 3, pp. 334-39, and Daniel S. Alfred, at Tr 3, pp. 468-69, provided testimony to address the costs of implementing the new SRUs. As shown in Exhibits A-75 to A-77, and testified to, at Tr 4, pp. 468-69:

Exhibit A-75 (DSA- 60) quantifies the revenue requirement impact of the switch from capital to O&M dollars due to the implementation of the new Standard Retirement Units. While there will be a dollar for dollar increase in revenue requirement for the additional O&M expenses, there is a reduction in revenue requirement for the decreased rate base that results from reduced capital expenditures. Lines 1 through 9 determine the total amount on Line 10 of dollars that will transfer from capital expenditures to O&M expense. . . . The Line 10 total of \$7,053,000 also represents the increase to the revenue requirement due to the dollar for dollar impact of the increased O&M expenses. Lines 11 through 14 calculate the reduction to the revenue requirement due to the now reduced capital expenditures level. Line 15 represents the net revenue requirement of \$6,533,014 as determined by the increased O&M expenses [\$7,053,000] and decreased capital expenditures [\$519,986].

Staff seems to agree with these adjustments by stating that Consumers "discusses how it would propose implementing the financial effect of these [SRUs] . . . . Staff agrees that this provides a reasonable basis for making the initial adjustment for the [SRUs] in this case. No other party commented upon Consumers' calculations and they are accepted. As a result, a projected increase of \$7,053,000 to 2008 O & M is appropriate for the projected test year.<sup>10</sup>

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<sup>10</sup> It is unclear whether the parties have fully accounted for capital adjustments resulting from the new SRUs. None were independently made in drafting this PFD.

### Corporate Services O & M

Consumers projects this expense to decrease \$1,671,000 for the 2010 test year. For the reasons explained below, this figure is accepted.

### Account 923 - Outside Services

Staff recommends a \$3,300,000 reduction to Consumers' Account 923 Outside Services in Corporate Services O&M, arguing that this was a one time expenditure in 2008. Staff Initial Brief, pp. 27-28. Consumers agrees that this was a one time expenditure and claims it did not include it in the development of test year O&M. Consumers Initial Brief, p. 603. Consumers claims Staff fails to recognize the offsetting net increase in computer operating costs for a full year of operations versus a half year in the 2008 historical year. This net increase is a result of higher licensing and maintenance fees versus the in-house developed legacy system. Based on Consumers' explanation, its projection is accepted.

### Account 925 - Injuries and Damages

Based on a five-year average, Staff recommends an increase of \$166,390 over the 2008 historical year. Staff Initial Brief, p. 28. Consumers accepts this adjustment and it is adopted.

### Accounts Receivables Sales Costs

From the record, it appears that Staff has adopted and recommends a \$1,864,000 increase to Accounts Receivable Sales costs for the 2010 test year. This figure is, therefore, adopted.

### Advanced Metering Infrastructure (AMI)

“The proposed AMI Program will consist of integrated systems that will measure, collect and analyze energy usage information. The system will include electric and gas meters capable of transmitting and receiving data (smart meter), a two-way communications network, a system to manage the data, enterprise/asset management software and a customer interface.” Tr 3, p. 415.

“The program’s emphasis for the . . . September 2010 [test year] will be the assessment, development and evaluation of systems and field equipment including a pilot of approximately six thousand smart meters which will include approximately four hundred pilot gas meters. Transition from the AMI Pilot to full-scale electric smart meter deployment and the addition of communication modules to existing gas meters is anticipated to commence in 2011 and be completed by 2015.” Tr 3, p. 416. Through 2015, Consumers projects AMI capital expenditures of \$855,000,000, of which, \$230,000,000 is allocated to gas operations Tr 3, p. 418.

On this record, Consumers claims gas customers will benefit from enhanced customer service, O&M effectiveness and efficiency improvements, and reductions in uncollectible accounts and theft. Additionally, consumers anticipates that the billing accuracy will improve by reducing estimated meter reads and on-demand actual reads will be available to respond to customer move-in/move out requests and to address questions concerning energy usage. It is further claimed that AMI can encourage energy efficiency and conservation by allowing customers to identify savings opportunities and validate the effectiveness of actions taken. Tr 3, pp. 416-17.

Consumers adds, at Tr 3, p. 417:

In conjunction with the AMI Pilot, which includes the continued evaluation of AMI technology, systems and deployment including piloting SMART meters, evolving industry best practices and/or anticipated Commission ordered guidance will continue to be applied to directly measure or reasonably estimate, evaluate and refine the anticipated costs and benefits of AMI technology, systems and deployment.

Consumers is asking for approval of AMI Program capital expenditures for year 2009 and the nine months ending September 2010 of \$8,097,000 and \$22,894,000, respectively. Tr 3, p. 418. Exh. A-34. Consumers also projects a test year O&M expense level of \$854,000 Tr 3, p. 418. Exh. A-27. Staff agrees with these figures.

The Attorney General objects to all expenditures on this program. As the Attorney General sees it, at AG Initial Brief, pp. 19-21:

The concern about this new AMI pilot program is not whether or not AMI is a good technology or whether it will provide some benefit to customers. Rather, the concern is whether Consumers has shown that it is reasonable to expend \$230 million in capital expenditures by the end of 2015 which increases cost of capital by millions without providing any cost/benefit analysis to determine if the benefits to the company and customers outweigh the costs. Consumers has already incurred \$10.1 million in capital expenditures for this project and is proposing to incur a[n] additional \$31 million to assess, develop, and evaluate systems and field equipment – all without ever conducting a cost/benefit analysis or . . . providing a cost benefit analysis to support its request in this filing. (Tr 1147). Although Consumers has provided some general ideas of savings in response to the Attorney General's discovery request for a cost/savings analysis, Consumers has not done the type of detailed cost/savings analysis a reasonable person would expect before expending millions of dollars in study and hundreds of millions of more to implement the AMI project. (Tr 1148). As stated above, Consumers bears the burden of proof in this rate case. Consumers must show the reasonableness of its rate increase request. Absent a detailed cost/benefit analysis showing the reasonableness of these costs, the Commission should reject Consumers' proposed AMI project and require such a study before approving it.

In addition to the lack of a cost/benefit analysis, there is the timing of the AMI project that is a concern. As Mr. Coppola explained:

The second issue I have with the Company's proposal is with its timing. Beginning such a program in the midst of a

severe economic recession in Michigan, when the Company is facing lower gas revenue, requires the Commission to grant higher rates to the Company to recover the cost of this investment. As I described above under the Capital Expenditures section of my testimony, higher capital expenditures increase the Company Rate Base. Each \$30 million increase in rate base translates into approximately \$2.2 million in first year cost of capital if we apply the Company's proposed cost of capital rate. This cost will increase accordingly as the entire \$230 million in capital expenditures are made to implement the entire program. Such a costly program if properly justified should be deferred until economic conditions in Michigan improve and the Company's revenues rebound to at least partially offset the impact on customer rates. (Tr 1148-1149).

Accordingly, the Attorney General requests that the Commission not approve any capital expenditures for the AMI program and require Consumers to file a comprehensive cost/benefit analysis about the AMI program in its next rate case and defer incurring any further capital expenditures until the Commission has approved continuation of the program. (Tr 1149).

ABATE is in general support of the Attorney General's position and opposes recovery of AMI expenditures through rates. ABATE states, at ABATE Initial Brief, pp. 16-17:

There is absolutely no showing that investment in AMI will provide a needed utility service to gas customers or that it will produce benefits in excess of the costs.

On its face, what conceivable benefits could flow from the installation of AMI? Gas use per customer continues to decline, as do the number of gas customers in Michigan. Based on average rates charged for non-fuel revenues and the weather patterns in Michigan, conservation and energy efficiency will not be encouraged by having real-time data on energy usage. People need to stay warm, and if customers have enough money, they will install conservation and energy efficiency devices in response to the federal tax credits. AMI on its face appears to be a total waste of scarce capital.

In Case No. U-15645, in reference to AMI, the Commission stated its opinion that "[t]his project is essential to the future of Michigan". *Application of Consumers Energy Co*, U-15645, Opinion and Order, p. 59 (November 2, 2009). Without such guidance

from the Commission, I might find the Attorney General's and ABATE's arguments convincing. On this record, it is difficult to envision what benefits will be conferred upon natural gas customers sufficient to justify the AMI expenses. However, in its November 2, 2009, Opinion and Order, it seems clear that the Commissioners have waived the AMI train out of the station. While I have serious concerns about whether the benefits of this project warrant expenditure of a quarter of a billion dollars, any policy reversal, shall come from the Commissioners and not this ALJ. For this reason, Consumers projected AMI expenses are excepted.

#### Manufactured Gas Plant Recovery

Staff finds Consumers' MGP expenses from July of 2008 through August of 2009 to be reasonable. Tr 4, p. 770. Staff's calculation of the expense for the 2010 test year is shown in Exhibit S-3, Schedule C-6.1.

Staff recommends MGP Net Amortization of \$3,262,129 for the 2010 projected test year and Consumers agrees. Staff Initial Brief, p. 29. Consumers Reply Brief, p. 6. This is an increase of \$235,129 for the projected test year. Exhibit S-3, Schedule C-6.1. Consumers then adjusts this figure downward by \$200,000 to arrive at a MPG amortization expense increase of \$35,000 for the 2010 test year. This figure is adopted. An additional \$52,000 is accepted for MGP Direct Project Management costs. See Consumers Initial Brief, Appendix D, p. 1.

#### Rounding

Staff incorporates a \$56,000 downward adjustment for rounding. This is adopted.

### Low-income and Energy Efficient Fund (LIEEF)

Consumers and Staff propose no adjustment to the \$17,427,000 for LIEEF; the amount previously approved in Case No. U-15506.

However, the Attorney General, in his initial brief, at pages 31-34, questions the “Commissions’ jurisdiction and power to authorize imposing LIEEF costs upon ratepayers to subsidize low-income customers.” AG Initial Brief, p. 31. This argument is, almost, word for word, the same that the Attorney General presented to the Commission in Case No. U-15768/15751.

ABATE, in its initial brief, at pages 17-19, presents a legal argument that mirrors that of the Attorney General’s, in opposition of LIEEF expenditures.

As noted by Staff, at *Application of The Detroit Edison Co*, U-15768, Opinion and Order, p. 53 (January 11, 2010), the Commission found:

The primary goal of statutory interpretation is to ascertain and give effect to legislative intent. *Casco Twp. v Secretary of State*, 472 Mich. 566, 571; 701 NW2d 102 (2005). The Commission finds that . . . the elimination of Section 10d(6) by the Act 286 amendments merely removed a portion of the statute that was no longer relevant to funding of the LIEEF. Nevertheless, the Legislature has evinced a clear intent to continue the LIEEF by continuing to appropriate funds for the program and by the passage of Act 172 that provides an additional source of funding for the LIEEF. The Commission therefore rejects the arguments raised by the Attorney General and ABATE and approves . . . for funding of LIEEF.

The Commissions’ decision in U-15768 is well-reasoned, sound, and adopted in this case. Recognition of the \$17,427,000 for LIEEF is accepted.

## Depreciation

Staff recommends a depreciation expense of \$125,652,000 for the 2010 test year. Staff Initial Brief, p. 29. Consumers agrees. Consumers Initial Brief, p. 70. Consumers Initial Brief, Appendix C. This figure is adopted.

## Taxes

### Property Taxes

Staff and Consumers agree that, for the projected test year, property taxes should be calculated at \$45,500,000. Tr 4, p. 697. Exhibit S- 3, Schedule C-7. Consumers Initial Brief, p. 70. This is \$4,111,000 more than the 2008 test year. No party disputes this figure and it is adopted.

### Other Taxes

Staff and Consumers agree that, for the projected test year, other taxes<sup>11</sup> should be calculated at \$15,946,000. Consumers Initial Brief, p. 70. Consumers Initial Brief, Appendix C. Staff Initial Brief, p. 30. Exh. S-3, Schedule C-7. This is \$1,189,000 more than the 2008 test year. No party disputes this figure and it is adopted.

### Accounting

Staff and Consumers recommend that, for ratemaking and accounting purposes related to the MBT, the Commission adopt the income tax policy authorized in Case No. U-10083. Staff Initial Brief, p. 30. Consumers Initial Brief 71. Additionally, Consumers requests Commission authorization to charge the income tax effect of the equity component of AFUDC as a FAS 109 regulatory asset. Consumers Initial Brief, p. 71.

Specifically, [it is recommended that] the Commission's order in this case should include the following authorizations:

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<sup>11</sup> This includes payroll taxes, other general taxes, and MPSC Assessment fees

1. Grant general authorization to use Accounts 190, 281, 282, and 283 offset by Deferred Income Tax Expense Account 410.1 or Credit Account 411.1 for book/tax temporary differences related to the MBT calculation originating on and after the date of the final order increasing rates in this case.

2. Grant general authorization to use Accounts 190, 281, 282, and 283 offset by a Miscellaneous Deferred Debit Account 186 for book/tax temporary differences related to the MBT calculation originating prior to the date of the final order increasing rates in this case.

3. Authorize assurance of recovery of the Miscellaneous Deferred Debit amounts in Account 186 related to the MBT calculation that will reverse in future years through current ratemaking practices.

4. Grant authority to charge the income tax effect of the equity component of AFUDC as a FAS 109 related regulatory asset, rather than deferred income tax expense, consistent both with Case No. U-10083 and FAS 109.” 3 Tr 329-330.

There being no opposition to these proposals, they are recommended.

#### Michigan Business Tax (MBT)

Based on its calculation of Net Operating Income, Consumers initially calculated a MBT expense of \$4,282,000. Consumers Initial Brief, p. 71. In its Reply Brief, Consumers revised its figure to account for Buy/Sell revenues, AMA revenues, and depreciation order changes. The calculations are presented in Appendix RB-2 of the Reply Brief and show Consumers revised projection of \$4,383,000.

Staff calculates a MBT expense of \$7,372,000, based on a current MBT expense of \$8,607,000 and Deferred MBT expense in the amount of a \$1,235,000 credit for the test year. 4 Tr 698. Staff’s calculation was based on the revenue, cost of gas sold and capital expenditure additions that were projected by Commission Staff (Exhibit S-3 Schedule C-1). Tr 4, p. 698. Consumers attributes the difference between its and Staff’s MBT expense to different reserve and expense assumptions.

From the record, I am unable to determine which of the two projections is more accurate. For the purpose of this PFD, I have adopted Staff's methodology, substituted revised data, where applicable, and estimated a MBT of \$7,023,000.

#### Federal Income Tax (FIT)

"Exhibit S-3 Schedule C-8 presents Staff's calculation of the FIT expense of \$33,215,000. Staff projected the [FIT] expenses for the test year ending September, 2010 based on Staff's projected Revenue, O&M expenses, depreciation and amortization, property and other taxes, and Interest Synchronization." Tr 4, pp. 697-98 This figure includes Staff's \$2,308,000 negative adjustment to the Pro Forma Income Tax Savings in Exhibit S-3, Schedule C-12. Staff Initial Brief, p. 31.

Consumers originally requested adoption of \$24,569,000 for FIT. Consumers Initial Brief, p. 72. Consumers Initial Brief, Appendix C, line 14. This includes adjustments for the income tax effect of interest and the interest synchronization adjustment. Consumers Initial Brief, p. 72. In its Reply Brief, Consumers revised its figure to account for Buy/Sell revenues, AMA revenues, and depreciation order changes. The calculations are presented in Appendix RB-2 of the Reply Brief and show a new projection of \$25,151,000 by Consumers. Consumers attributes the difference between Consumers' and Staff's FIT expenses to different revenue and expense assumptions. Consumers Initial Brief, p. 72.

As with the MBT, from the record, I am unable to determine which of the two FIT projections is more accurate. For the purpose of this PFD, I have adopted Staff's methodology, substituted revised data, where applicable, and estimated a FIT of \$29,872,000.

### Allowance For Funds Used During Construction (AFUDC)

Consumers and Staff agree that the amount for AFUDC should be set at \$1,290,000. Consumers Initial Brief, p. 72. This figure is adopted.

### Calculation of Adjusted Net Operating Income

For the projected test year, Consumers calculates a net operating income of \$137,721,000. Consumers Initial Brief, p. 72. Consumers Initial Brief, Appendix C. Staff calculates \$156,064,000. Staff Initial Brief, p. 20. Exh. S-3, Schedule C-1. Based on the above, I project net operating income of \$150,857,945. See Appendix B.

## **OTHER ISSUES**

### Revenue Decoupling Mechanism (RDM)

MCL 460.1089(6) reads:

The commission shall authorize a natural gas provider that spends a minimum of 0.5% of total natural gas retail sales revenues, including natural gas commodity costs, in a year on commission-approved energy optimization programs to implement a symmetrical revenue decoupling true-up mechanism that adjusts for sales volumes that are above or below the projected levels that were used to determine the revenue requirement authorized in the natural gas provider's most recent rate case. In determining the symmetrical revenue decoupling true-up mechanism utilized for each provider, the commission shall give deference to the proposed mechanism submitted by the provider. The commission may approve an alternative mechanism if the commission determines that the alternative mechanism is reasonable and prudent. The commission shall authorize the natural gas provider to decouple rates regardless of whether the natural gas provider's energy optimization programs are administered by the provider or an independent energy optimization program administrator under section 91.

"[T]he Commission has approved an energy optimization plan for Consumers that, for each year through December 31, 2014, includes a spending level in excess of

the 0.5% standard.” Tr 4, p. 815. Therefore, under MCL 460.1089(6), the Commission is required to approve a RDM.

Consumers presented the testimony of Rachel Pender to describe its proposed RDM. Tr 4, 620-90. At Consumers Initial Brief, pp. 74-74, Consumers states:

[Consumers] is proposing that the RDM be applicable to all retail and transportation gas customers. The RDM would establish a base line average annual usage per customer for each customer rate class (“baseline average Mcf”) as approved by the Commission in the most recent general rate case. Annually thereafter, the Company would determine the actual annual average consumption per customer class (“actual average Mcf”) and compare that to the baseline average for each rate class. If the actual average Mcf is below the baseline average Mcf, then Consumers Energy would multiply the difference by the number of customers in that class as established in the most recent general rate case. The resulting volume would then be multiplied by the distribution charge as approved by the Commission in the most recent general rate case, to derive the total amount of revenue to be collected from that rate class. Consumers Energy proposes to collect this amount through an equal per Mcf surcharge applied to all customers in that class over the subsequent twelve months following Commission approval. At the end of the twelve month period, Consumers Energy would determine any over-collection or under-collection of the RDM amount and roll that amount into the determination of the next period RDM adjustment. 4 Tr 626-627.

If the actual average Mcf is higher than the baseline average Mcf for a rate class, then Consumers Energy would use the same methodology to determine the over-collection of revenue and calculate a per Mcf credit to be returned to customers in that class over a subsequent twelve month period. Consumers Energy proposes to reconcile the RDM along with its annual EO reconciliation process to permit timely collection or refund of significant amounts. An example of how the revenue decoupling mechanism would be applied is demonstrated in Exhibit A-53 . . . . The Company proposes to apply the RDM to residential, general sales and transportation customer classes, and include customer choice sales. 3 Tr 627.

[Consumers] believes that its proposed RDM will enable [it] to maintain its traditional rate design (i.e., volumetric-based rates) which maximizes the incentive to participate in the EO program and continue to motivate customers to improve energy efficiency. The proposed RDM methodology is also administratively simple to implement. An important further benefit is that its adoption will minimize the contentious issue of establishing sales in future general rate cases. 3 Tr 628.

Consumers argues against proposals for a weather normalized RDM. To justify this position, Consumers states, at Consumers Initial Brief, pp. 75-76:

The RDM proposed by the Company would ensure that when customer consumption is greater than the level established in rates due to a colder winter, the Company would refund the over-collection and when consumption is lower the Company would be able to collect its authorized non-fuel revenue. Weather normalization after a colder-than-normal winter would likely reduce or eliminate any over-collection and thus there would be lesser or no refunds to customers. However, if during a warmer-than-normal winter the utility's revenues are reduced, there is little motivation for the Company to further reduce sales by promoting energy efficiency. The Company's proposal maintains the motivation for the Company to promote energy efficiency even though it results in reduced energy sales. 4 Tr 646.

Staff presented the testimony of Robert Ozar to describe its RDM proposal. At Tr 4, p. 816, he stated:

It is Staff's recommendation that Consumers be ordered to file a sales revenue decoupling true-up application within 90 days of the end of each 12-month period in which rates pursuant to the Commission order in this case have been in effect for 12 consecutive months. Upon receipt of the application, the Commission will commence a decoupling true-up proceeding. The proceeding will reconcile actual jurisdictional revenue with jurisdictional revenue requirements as established in the Commission's order in this case. In its true-up filing, Consumers should include a proposal for allocating the surcharge (or refund) across customer classes. The decoupling surcharge should be implemented until such time that the Commission authorizes a new decoupling surcharge.

\* \* \*

Jurisdictional revenues should be calculated net of revenues related to: (1) customer charges and; (2) natural gas revenues related to Gas Cost Recovery (GCR) charges, and refunds.

Staff's proposed RDM would be weather normalized. Tr 4, p. 818. Staff's proposal does not include a method for allocating any over- or underrecovery by rate class, but would require Consumers to present such a proposal with its true-up application. Tr 4, p. 822-23. Staff Initial Brief, p. 32. Except for weather, Staff's proposed RDM would true-up for any revenue change. Tr 4, p. 824.

Staff argues that its weather normalized proposal is preferable “because gas companies’ sales levels are more closely linked to weather variability than the sales levels for electric” and because weather normalized RDM for gas utilities will reduce “rate volatility” and reduce the “magnitude of surcharge levels”. Staff Initial Brief, p. 33.

The Attorney General argues for a revenue decoupling mechanism that “is very limited in scope.” AG Initial Brief, p. 14. The Attorney General argues, at AG Initial Brief, p. 14, that:

[T]he Commission should reject Consumers proposed revenue decoupling mechanism that allows Consumers to recover for losses in natural gas usage due to weather, the economy, or other reasons. Instead, the revenue decoupling mechanism should be limited to the recovery of loss sales due only to energy conservation since this is the stated purpose of the Act. . . . Consumers expanded revenue decoupling mechanism exceeds the purpose of 2008 PA 296 and the Commission's authority to approve such an expanded decoupling mechanism.

The Attorney General recommends a RDM that normalizes for weather, that splits “transportation volumes for large-volume customers . . . from the rest of the transportation volumes and appl[ies] an annually calculated conservation reduction rate to the volumes authorized in rates”, and that does “not include an on-going reconciliation procedure for recovery or refund of . . . revenue after the first year the surcharge or refund is applied to customer bills.” AG Initial Brief, p. 14.

ABATE primarily focused on the implications of Consumers proposal for rate ST, LT, and XLT customers. ABATE states, at ABATE Initial Brief, p. 10:

The results of Consumers’ proposal are unreasonable. For example, if new customers came onto the system but had average use less than the average established per customer in the base case, then all customers in that class would be subject to a rate increase. 4 T. 660. It is absolutely unreasonable to surcharge the class when Consumers has received incremental revenue from new customers that unfortunately do not have the same average use as set forth in base rates. Not only does

Consumers receive incremental revenue from the new customers, but also would receive incremental revenue from the existing customers under Consumers' proposals. Also, Consumers is not proposing to turn off the UTM or RDM if the authorized rate of return is being met or exceeded. 4 Tr 670-671.

ABATE recommends a RDM that is restricted to recovery of "revenue due to Consumers' energy optimization plan. On the other hand, if the Commission approves a broad-based decoupling mechanism, then it should be trued-up on the basis of class revenue, not average use per customer by class." ABATE Initial Brief, p. 11.

ABATE objects to the lack of specificity in Staff's RDM proposal. ABATE states its position, at ABATE Initial Brief, pp. 13-14:

Staff proposal would leave it totally up to the discretion of the Commission as to how to allocate any under- or over-recovery. It could even move revenue responsibility or the refund between classes. ABATE recommends that the Commission reject this position and adopt a complete mechanism at this time.

The piecemeal approach recommended by the Staff will lead to administrative inefficiencies in that it will absolutely require that organizations such as ABATE participate in the reconciliation proceeding if revenue responsibility is not determined at this time. In addition, the parties would be forced to take one or more appeals to finally settle the revenue decoupling issues. Again, this is very inefficient and wastes valuable resources.

\* \* \*

Customers need to know at the time any decoupling mechanism is approved exactly how it will work and affect their future gas costs. Unless a full decoupling mechanism is revealed at this point, it will only increase the economic uncertainty and add one additional reason why large industrial customers should attempt to leave the system through the installation of a pipeline by-pass or relocate production to another state.

Under the circumstance presented, approval of a RDM is mandated by MCL 460.1089(6). The only apparent question is what form the RDM should take. I agree with arguments that the RDM should, to the greatest extent feasible, be limited to compensate Consumers for lost sales that result from actual conservation measures. None of the proposals are particularly well tailored to achieve that goal. However, with

that in mind, I suggest adoption of Consumers' proposed RDM with the additional requirement that sales be weather normalized. Finally, Staff's filing timelines appear reasonable and should be adopted.

Pension Equalization Mechanism (PEM) and Other Post Employment Benefits Equalization Mechanism (OPEB)

Consumers claims that a PEM "is necessary to allow recovery of reasonable pension expenses which are the result of various factors and market conditions over which [Consumers] has no control." Consumers Initial Brief, pp. 78-79. "A pension tracker will allow recovery of reasonable pension expenses, as well as avoid recovery from customers that is greater than the actual pension expense." Consumers Initial Brief, p. 79. For the same reasons, Consumers has proposed a tracker mechanism to allow recovery of reasonable retiree health care and life insurance expenses.

As explained at Consumers Initial Brief, p. 82:

The PEM and OPEB reconciliations would be included in the annual Reconciliation of Gas Cost Recovery Costs and Revenues. Combining the PEM/OPEB reconciliations with the annual GCR reconciliation eliminates the need for a separate proceeding. PEM and OPEB mechanisms will be reconciled in the same manner to each other. If the actual annual expense is greater than the expense in rates, this difference would be recognized as a regulatory asset for future recovery and collected through a monthly equal amount per Mcf surcharge to customers. If the actual annual expense is less than the expense in rates, this difference would be recognized as a regulatory liability and would be distributed to customers through a monthly equal amount per Mcf credit. 4 Tr 630.

Staff argues that, because of PA 286 of 2008, Consumers "no longer needs these mechanisms because the Act virtually eliminates regulatory lag." Staff Initial Brief, p. 34. "Staff urges the Commission to reject Consumers' . . . PEM . . . and OPEB

mechanism because there is little risk that Consumers will under-collect these costs, particularly if the Commission adopts Staff's projections." Staff Initial Brief, p. 35.

In response, Consumers argues that, the timing of rate cases and when it knows these actual expenses, leaves customers subject to over or under collection. "Due to the large size of these two expenses and the variability that they can have from year to year based on market conditions outside the Company's control, trackers for these expenses are the best way to make sure the actual expense is what is paid and collected in rates." Consumers Initial Brief, p. 81.

ABATE argues that regardless of whether the Commission approves the RDM, it should not approve either of these mechanisms. ABATE Initial Brief, p. 13. ABATE argues that, with approval of a RDM, "the need for these other tracking mechanisms diminishes or may be completely eliminated." ABATE Initial Brief, p. 11. As a matter of policy, ABATE opposes "the use of riders and tracking mechanisms because they shift regulatory risk" from investors to customers. ABATE Initial Brief, p. 11. ABATE, also, objects because this mechanism allows Consumers to recover revenue on a "piece-meal basis" without permitting review of rates in a full rate case proceeding. ABATE Initial Brief, pp. 11-12. "[These] automatic adjustment clauses . . . were previously terminated by the Commission, and in a separate case, Detroit Edison proposed the elimination of these items and the Commission agreed. They should not be approved . . . ." ABATE Initial Brief, p. 13.

Consumers objects to ABATE's criticism that trackers shift regulatory risk from Consumers' investors to its customers. Rather, according to Consumers, as stated at Consumers Initial Brief, pp. 81-81:

Approval of these trackers reflects a symmetrical risk allocation between the Company and customers. These trackers would assure customers that they will pay the actual cost for these benefits and not over pay or under pay for them. From the customers' perspective, the trackers are very beneficial in market conditions which include high interest rates and/or rapidly increasing plan asset values. These situations can lead to lower pension and OPEB expenses and, as a result, a reduction in the customer's costs for these benefits. Without trackers in place during these kinds of market conditions when expenses are calculated, there is no timely way to reduce customer costs for these benefit expenses. In this manner, trackers shift regulatory risks away from customers. 5 Tr 898.

The Attorney General opposes these mechanisms. The Attorney General feels they will reduce incentives for Consumers to reduce costs. The Attorney General claims these expenses are predictable and can be recovered in rates without the need for the mechanism.

I find Consumers' proposals and arguments in favor of the PEM and OPEB convincing. I agree with Consumers that these expense items are, to a large degree, the result of various factors and market conditions beyond its control. I believe it advantageous to Consumers and its customers that these expenses be properly and timely funded. The PEM and OPEB should do that. Nonetheless, I agree with ABATE that the PEM and OPEB lessen the risk to investors. As Consumers argues, the PEM and OPEB are necessary to address costs over which it has "no control". Clearly, these costs represent a risk to Consumers and its investors. Because the PEM and OPEB will significantly reduce Consumers' exposure to these uncontrollable costs and thus reduce risk to investors, this reduced risk should be reflected in a lower return on common equity.<sup>12</sup>

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<sup>12</sup> My recommended ROE of 10.45% was not adjusted lower to account for approval of a PEM or OPEB. Appropriate adjustments to the ROE are recommended, if these mechanisms are approved.

### Uncollectible Expense True-up Mechanism (UETM)

Consumers has proposed an UETM in response to its recently increased uncollectible expense. Consumers believes that “[an] uncollectible true-up mechanism would protect both the Company and customers from the risk of inaccurate ratemaking projections of this expense.” Consumers Initial Brief, p. 77. Consumers describes how its UETM would work at Consumers Initial Brief, p. 79:

[Consumers] proposes to create a +/-5% deadband such that if actual uncollectible expense in future years is within 5% of the base uncollectible expense amount as established, no adjustments would be made. However, if the annual uncollectible expense is 105% or greater of the base uncollectible expense level approved [by] the Commission in this case, the Company would, following notice and hearing, prospectively adjust rates upward, through an appropriate surcharge, so the Company is collecting 100% of the amount over the 5% deadband. If, on the other hand, the annual uncollectible expense is 95% or less of the base uncollectible expense level, then the Company would refund 100% of the amount outside the 5% deadband. 4 TR 629. Although the level of uncollectible expense is somewhat out of the Company's control, the Company remains at risk for 5% of its uncollectible expense as an incentive to minimize the expense to the greatest extent possible. 4 Tr 629.

The UTM will be administered by the Company submitting an application to the Commission. This application will include the information on any difference between the uncollectible allowance and the actual uncollectible amount by March 31 of each year for the preceding calendar year. The application would be noticed with an opportunity for a hearing. The elements of the application should be narrow enough in scope to allow a prompt hearing and Commission order to facilitate timely implementation of the UTM credit or surcharge. 4 Tr 629.

As with the PEM and OPEB, Staff argues that Consumers no longer needs this mechanism because PA 286 of 2008 virtually eliminates regulatory lag and because there is little risk that Consumers will under collect this cost. Staff Initial Brief, pp. 34-35. In the alternative, as explained, at Staff Initial Brief, pp. 35-36:

Staff urges the Commission to implement a mechanism similar to the one it approved for the Michigan Consolidated Gas Company (MichCon) in Case No. U-13898. 4 TR 757. As Staff witness Mr. Daniel

Blair testified, to adopt a mechanism similar to MichCon's mechanism, the Commission would have to make the following modifications to Consumers' proposed mechanism:

1) The base uncollectible expense would be the amount of \$26,682,000 as recorded in their P-522 annual report for 2008 adjusted as uncollectible expenses net of write offs or PeopleCare reimbursements. 2) Consumers would record as a regulatory asset or liability 90% of the difference between actual uncollectible expense and the 2008 base amount. 3) The surcharges or credits for each rate schedule would be calculated upon the percentages of uncollectible expense allocated to the rate class in the cost of service study utilized in the final rate design approved by the Commission. [4 Tr 757.]<sup>25</sup>

MCAAA opposes the UETM because, it claims, Consumers has overestimated its 2010 uncollectible expenses and, by doing so, guarantees that Consumers will always be in an overrecovery status and, therefore, retaining 5% of the overrecovery. MCAAA adds that the mechanism removes virtually all incentive for Consumers to address uncollectible expenses and support programs to help customers address their energy costs and that the proposal does not include "meaningful" Commission review. MCAAA Initial Brief, p. 12-13. Additionally, MCAAA points out that, depending on how this true-up mechanism and the RDM are designed, there could be some overlap in their operation and that neither mechanism contains "any provisions for [their] suspension . . . when [Consumers] is earning in excess of its authorized return". MCAAA Initial Brief, p. 14.

ABATE states that should the Commission approve the RDM it should not approve a UETM. ABATE argues that, with approval of a RDM, "the need for these other tracking mechanisms diminishes or may be completely eliminated." ABATE Initial Brief, p. 11. As a matter of policy, ABATE opposes "the use of riders and tracking mechanisms because they shift regulatory risk" from investors to customers. ABATE

Initial Brief, p. 11. ABATE, also, objects because this mechanism allows Consumers to recover revenue on a “piece-meal basis” without permitting review of rates in a full rate case proceeding. ABATE Initial Brief, pp. 11-12. Alternatively, ABATE recommends that the 5% deadband be expanded to 10%.

The Attorney General opposes the UETM. The Attorney General feels the mechanism will reduce incentives for Consumers to reduce uncollectibles. The Attorney General claims uncollectible expenses can be recovered in rates without the need for the mechanism.

I do not recommend approval of Consumers’ proposed UETM. As MCAAA points out, given the current unusually high uncollectibles, it appears that Consumers’ proposal would likely place it in a position to retain overrecoveries. Furthermore, I agree with MCAAA that the proposal removes incentives for Consumers to control uncollectible expenses. Additionally, in light of the recommendations regarding the RDM, PEM and OPEB, the request to add an UETM appears ill-timed. Working out the details of these three mechanisms should be completed prior to consideration of the UETM.

#### Taft-Hartley Training Trust Fund

MSUWC presented evidence regarding the age of Consumers’ workforce and workforce training expenditures. At MSUWC Initial Brief, p. 3, MSUWC states:

Consumers’ informal responses to discovery requests propounded by the Council indicate that Consumers anticipates retirements over the next five years of over 1,000 organized work force employees (30% of the current work force). With respect to Energy Distribution Department training expenditures over the next two years, Consumers’ projects a total of \$45,739,403 (\$17,285,906 for Gas Line Workers alone).

\* \* \*

The UWUA Power for America Taft-Hartley Training Trust protects and ensures the availability of the necessary training funds to meet the aging work force challenge, maintain worker and public safety and the public reliability of the critical natural gas services provided by Consumers’.

MSUWC argues that the Commission has authority to order Consumers’ funding of a Taft-Hartley Training Trust Fund, pursuant to MCL 460.6 and MCL 460.7. MSUWC Initial Brief, pp. 7-8.

Consumers, however, argues that the Commission lacks authority to order a Taft-Hartley Training Trust Fund and that this is a matter for collective bargaining. Consumers Reply Brief, pp. 63-64. Additionally, Consumers argues that creation of the trust fund would unreasonably interfere with Consumers’ ability to manage its business and that there is no evidence to establish that necessary training funds won’t be available when needed. Consumers Reply Brief, pp. 63-63.

In Case No. U-15645, the MSUWC presented, largely, the same argument in regards to Consumers’ electrical workers. In that case, the Commission in its November 2, 2009, Opinion and Order, at page 61, ordered Consumers to file, within 90 days, a utility workforce training report evaluating present and expected future training needs, present and future training costs, and the costs and benefits to the utility and the public of a ratepayer-funded training trust. See *Application of Consumers Energy Co*, U-15645, Proposal for Decision, p. 156 (September 2, 2009). For consistency’s sake, I recommend the same be ordered in this case<sup>13</sup>.

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<sup>13</sup> On February 1, 2010, Consumers filed its “Consumers Energy Company Report on Utility Worker Training”, in Case No. U-15645.

## Pooling

CNE requests that the Commission require Consumers to: “accept pooled [natural gas] nominations from marketers”; “[m]odify Consumers’ tariff to assess charges, including load balancing charges, authorized and unauthorized gas usage charges, and excess pipeline costs surcharges, based upon the net imbalance of a marketer’s pool”, and; “[i]mplement pooling of transportation customer storage and require that pool monthly injection rights are established based upon the pool member’s individual tariff rights”. CNE Initial Brief, p. 3.

As explained by CNE’s witness, James G. Germain, at Tr 6, p. 1075:

At its most basic level, pooling is simply the grouping together of transportation service customers that are all being supplied by the same marketer. It is certainly not a new concept in the industry, as many Customer Choice programs are predicated upon pooling or grouping many end-use customers together.

Mr. Germain continues, at Tr 6, pp. 1080-81, by stating:

[P]ooling simplifies the transportation service procedures for a marketer, thereby promoting efficiencies, reducing administrative burdens, and reducing the costs associated with transportation service. For example, if a marketer has 50 transportation customers, without pooling, that marketer will need to submit 50 separate nominations to a utility. If all of those customers can be grouped into a single pool, that marketer then is able to submit a single nomination to the utility. While this alone may not seem like a major difference, when you factor that by each separate LDC, multiply it by the number of customers within each utility, and consider that for many customers consumption varies by day, the volume of separate transactions that can be reduced can result in significant savings of time and resources for a marketer. This is especially important in light of the fact that all nominations, no matter location, are subject to the same pipeline timetable.

As explained at Tr 6, p. 1082:

Transportation service is based upon the customer or its marketer providing the utility with the volume of gas that will be delivered to the utility on behalf of the customer. This is typically the estimate of

consumption for that day and is referred to as a nomination. The utility then anticipates this volume and makes plans to operate the system based upon this information. However, as no one can forecast consumption with 100% accuracy, there is always some deviation between the volumes delivered to account for expected usage; i.e., the nomination and the actual usage or consumption by customers. Thus, an imbalance occurs between anticipated and actual usage. In order to encourage accuracy in the nominations that are submitted, utilities typically assess a charge based on the degree of the imbalance. These costs often take the form of balancing and cash-out charges. Typically, the greater the magnitude of the imbalance, the higher the cost of that imbalance. Therefore, a marketer's objective is to minimize imbalances, thereby reducing costs.

\* \* \*

Pooling allows the marketer to net the imbalances of the transportation customers in the pool before any utility charges are applied.

Additionally, “[f]or the marketer, it is administratively simpler to maintain storage inventories, withdrawal, and injections in aggregate rather than manage each parameter of storage by individual customer.” Tr 6, p. 1085. “[M]uch like the netting of imbalances reduces balancing costs, the netting o[f] storage inventory can reduce costs for transportation customers.” Tr 6, p. 1086.

Consumers opposes CNE's proposal. Consumers claims that, while CNE's proposal may simplify matters for marketers, it is customers who will suffer. Consumers claims that CNE's proposal will “impair the flexibility for a transportation customer to switch marketers”, will “aggregate the ATL level of all customers”, thus, causing “cross-subsidization between customers”, and could allow marketers to “maximize nominations on certain days . . . when gas prices are low and minimize nominations . . . when prices are high”, which “could be problematic for” Consumers. Consumers Initial Brief, pp. 82-85. Consumers continues by claiming that “[p]ooling could lead to an unjust cost allocation for transportation customers and potentially lead to billing problems.” Consumers Initial Brief, p. 86. Consumers complains that a “pooling option would

further require [Consumers] to modify its Gas Nomination System and Billing system to keep track of its customer in a particular pool during a particular month” and that, if an error occurred in one account, billing for the entire pool would be reviewed and “rebilling could become an administrative nightmare”. Consumers Initial Brief, p. 87.

Staff presents arguments against pooling that, largely, mirror those of Consumers. Staff Initial Brief, pp. 42-44.

CNE counters these arguments by noting that, for the 2% of Consumers customers that purchase from more than one supplier, they may continue to do so by not participating in pooling. CNE Initial Brief, pp. 12-13. With regard to “cross-subsidization”, CNE notes that transportation customers are sophisticated enough to protect their interests and that 86% of Consumers transportation customers opt for the 8.5% default ATL. CNE Initial Brief, p. 14. CNE suggests one solution to cross-subsidization by requiring separate pools based on the ATL selected. CNE notes that, if billing is problematic for Consumers, Consumers could bill directly to the pool administrator and that contractual arrangements between Consumers and marketers could be entered into, if necessary, to facilitate such arrangements. CNE Initial Brief, p. 9. CNE dismisses Consumers’ concerns that problems could occur if marketers game the system, based on variations in gas prices, by noting that marketers can do so under the current system and that pooling wouldn’t alter marketers’ ability to do so. CNE Initial Brief, pp. 8-9.

ABATE supports CNE’s pooling proposal, but adds that it is “not a substitute for cost-based rates.” ABATE Initial Brief, p. 14.

In its Reply Brief, at pp. 7-8, ABATE adds:

ABATE represents some of the largest transportation customers on Consumers' system, and therefore, ABATE can speak with authority on how the availability of pooling will benefit transportation customers. Pooling will allow transportation customers to negotiate better rates with any marketer because the marketer has enhanced flexibility, lower costs and other business opportunities associated with pooling. For example, the marketer may arbitrage unused storage belonging to the marketer's customers if the customers agree to release the storage control to the marketer. This presents business opportunities to the marketer, and the customers giving up control of their storage associated with their individual loads can demand an adjustment in the marketer's fees or negotiate a piece of the economic benefit derived from the storage arbitrage. That is just one way pooling can benefit customers. Another benefit can be the more efficient use of transportation upstream of the city gate. If a marketer has a large pool of customers, then adjustments can be made either in the contract storage capacity or transportation reservations can be released into the market for the benefit of customers. Consequently, pooling should not be rejected for the reasons cited by the Staff.

The Staff also argues that there would be an enormous administrative burden placed upon Consumers based upon Consumers' self-serving statements. Other utilities have implemented pooling in Michigan, as pointed out by Mr. Germain in his testimony. Consumers has just recently installed a very sophisticated and very expensive computer software and related hardware for which customers have been paying. SAP software was highly touted as providing major benefits over and above the "legacy" systems previously employed by Consumers. Certainly, this sophisticated software system can be used to eliminate the so-called administrative burden. When weighing the facts, the existence of this software against mere allegations of an administrative burden should lead one to the conclusion that pooling should be implemented, at least on a pilot basis. If pooling were to increase Consumers' administrative burden, then it is incumbent upon Consumers to approach the Commission with more than mere allegations and estimate what the administrative cost would be and determine whether transportation customers should pay higher rates in exchange for the continuation of pooling. Therefore, the Commission should adopt the recommendations to implement pooling for Consumers' transportation customers.

I find CNE's pooling proposal reasonable and likely to benefit Consumers' customers, as well as marketers like CNE. I find Consumers' objections lacking in substance and unconvincing. There seems no doubt that, under pooling, Consumers will be required to make administrative changes to the way it conducts business. However, none of these adjustments seem significant. Additionally, it appears pooling

will not threaten or complicate the management of Consumers' natural gas system. Therefore, I recommend the adoption of appropriate tariff language to permit pooling and suggest that the details of a pooling program and the precise tariff language necessary for its implementation be resolved in further proceedings and that Consumers be given 60 days to file a detailed proposal, including specific tariff language, to permit pooling.

### **REVENUE DEFICIENCY**

Consumers claims a revenue deficiency for the 12-month test year ending September 2010 of \$103,821,000. Consumers Initial Brief, p. 94. Staff projects a deficiency of \$62,710,000. Staff Initial Brief, p. 1. The Attorney General finds a revenue deficiency of \$12,300,000. AG Initial Brief, p. 5. Based on the record and the arguments presented, I find a projected revenue deficiency of \$68,579,133 to be most reasonable. See Appendix D.

### **COST OF SERVICE, RATE DESIGN, AND TARIFF ISSUES**

#### **Cost of Service**

Consumers' witness, Thomas Yehl, presented Consumers' historical and test year gas Cost-of-Service Studies (COSS) by rate class. Mr. Yehl sponsored Exhibit A-73, a four page exhibit that summarizes the 2008 Historical Gas Cost-of-Service Study (2008 Historical COSS). At Tr 3, p. 485, it is explained:

The 2008 Historical COSS shows the Company's total rate base, rate of return on rate base, and index of return by rate schedule for 2008. It indicates that the residential and general service rate schedules, as well

as Rate ST and Rate LT, are near their cost based levels. However, it also indicates that Rate XLT is significantly below its cost based level.

Exhibit A-74 summarizes the results of Consumers' 2010 Test Year Gas Cost-of-Service Study (2010 Test Year COSS). At Tr 3, p. 486, it is explained that:

[T]he 2010 Test Year COSS incorporates the test year changes . . . into the 2008 Historical COSS, and the 2010 Test Year COSS was prepared utilizing cost allocation methodology consistent with past MPSC practice. Company witness Alfred calculates the revenue deficiency, which can be found on page 1, line 17, column (c) of Exhibit A-74 (TAY-2). The 2010 Test Year COSS then calculates the total revenue deficiency or sufficiency by rate class on page 1, line 17, columns (d) through (j) of Exhibit A-74 (TAY-2).

Staff witness, Bonnie Janssen, sponsored Exhibit S-5, Schedule F-6, Staff's Cost of Service Study. She explained, at Tr 4, p. 806, that:

[She] conducted Staff's Cost of Service Study by applying the same basic principles that were adopted by the Commission in Consumers' rate case in Case No. U-13000. This Cost of Service Study is based on Staff's projected 2009 test year revenue requirement of approximately \$739,227,000, which is the basis for Staff Witness Mr. Nicholas Revere's calculation of proposed rates. The results of the study are summarized on page 1 of Schedule F-6. The total revenue requirement for each rate class is shown on page 1, line 33 of this schedule and appears on Schedule F-1-2 sponsored by Mr. Revere.

Testifying on behalf of ABATE was Nicholas Philips, Jr. Mr. Philips presented ABATE's position regarding the COSS. At Tr 5, pp. 962-63, Mr. Philips states:

In my opinion, Consumers' cost of service study over-allocates costs to transportation customers. . . . Consumers' study is based on the "peak and average" allocation method, which allocates a significant portion of fixed, demand related cost on the basis of throughput. It is more appropriate to allocate the investment in mains on the basis of peak day demands. The peak day demand method is also more in accord with FERC's Straight Fixed-Variable Cost Method. In addition, Consumers allocates storage costs to transportation customers as if they were sales customers. This also results in an over-allocation of costs to transportation customers.

Additionally, ABATE argues that Consumers' COSS is flawed because Consumers' use of 50/50 weighting, between peak day and storage, is contrived and totally arbitrary. ABATE Initial Brief, pp. 7-8.

Mr. Philips adds, at Tr 5, pp. 963-64:

[T]here is simply no reasonable basis for the allocation of storage costs to transportation customers proposed by Consumers. For that reason, I have recalculated the Company's cost of service study with no storage costs allocated to transportation customers.

\* \* \*

The only "access" that transportation customers arguably have to the Company's storage facilities is the use of storage to cure inadvertent imbalances. Sales customers, on the other hand, enjoy the benefits of seasonal cost savings as a result of the Company's ability to purchase and store lower priced gas in the summer for use in the winter. In addition, they enjoy gas cost savings because the Company is able to save on pipeline capacity by using its storage to meet its peak demands. Transportation customers do not share in either of these benefits.

At Tr 5, p. 970, he adds:

The results of my modified cost of service study are summarized on Exhibit AB-2. In general, it shows that transportation customers are providing the highest rather than the lowest rates of return. Specifically, it shows that the Residential rate of return is below system average at 4.2%, the General Service rate of return is above system average at 5.4%, and the transportation customers' rate of return is by far the highest at 16.2%.

Consumers counters ABATE's arguments on several grounds. With regard to ABATE's criticism of Consumers' failure to use peak day data, Consumers notes that it did so because it was ordered to use peak month data in Case No. U-10755. Consumers Reply Brief, p. 55 In response to ABATE's 50/50 weighting argument, Consumers states it used "50/50 weighting . . . between peak month and storage in compliance with the Commission's Order in Case No. U-10755." Consumers Reply Brief, p. 55. In response to ABATE's criticism of the allocation of storage costs, Consumers states that the "amounts allocated to transportation customers are very

similar to the authorized tolerance level (ATL) which represents the amount of . . . storage that the customer is allowed to utilize, primarily to balance supplies and usage.” Consumers Reply Brief, p. 56.

After considering the record and the arguments, I do not find ABATE’s criticism of Consumers’ COSS convincing.

Staff and Consumers acknowledge that their cost of service studies are, essentially, the same, with one exception. Staff Initial Brief, p. 37. Consumers Reply Brief, p. 24. That exception is Consumers’ use of a design peak day throughput of 3,573,000 Mcf versus Staff’s use of a historical peak day of February 10, 2008, of 2,537,000 Mcf. Staff Initial Brief, p. 37. Consumers claims that its approach should be adopted because it “is consistent with the method previously approved by the Commission” and that “[i]t is not consistent to use a historic peak day with test year sales as this could distort the cost allocations in the [COSS].” Consumers Reply Brief, p. 24. Staff, however, argues that its COSS approach should be adopted because, “although no one can predict a future years’ peak day with perfect accuracy, Staff’s peak day relies on actual data from the historical test period.” Staff Initial Brief, p. 38. On this point, I accept Consumers’ arguments and find its approach preferable.

Contingent upon the Commission’s findings in this matter, I recommend adoption or recalculation of Consumers’ COSS.

#### Rate Design

Consumers proposes “delivery rates based on an equal percentage increase of 16.7% for all sales rates.” Consumers Initial Brief, p. 96. For the Transportation class, Consumers proposes a separate and higher equal percent increase of 20.6% to the

delivery rates. Consumers Initial Brief, p. 96. Consumers claims that the new transportation rates will not fully reflect the cost to serve the class, but moves closer to cost and mitigates rate shock. Consumers Initial Brief, p. 96. Consumers designed its rates to recover the target revenue of approximately \$84.8 million for residential service, approximately \$22.3 million for general service rates, and \$6.8 million for the transportation class. Consumers Initial Brief, p. 96. A summary of Consumers' proposed rate increases can be found in Exhibit A-55, Schedule F-3.

Consumers proposes to increase the residential customer charge from \$9.50 to \$11.00 per month. Consumers Initial Brief, p. 96. Additionally, Consumers proposes to increase the volumetric distribution charge from \$2.0819 to \$2.6188 per Mcf. Consumers Initial Brief, p. 96. Consumers recommends that the Excess Peak Demand Charge for residential Rate A customers be increased from \$0.0489 to \$0.0566 per Mcf. Consumers Initial Brief, pp. 96-97. Except for those taking service under rate schedule A-1, under Consumers' Income Assistance Service Provision, residential customers earning up to 150% of the federal poverty level will be eligible for a credit equal in amount to the customer charge. Consumers Initial Brief, p. 97.

Staff agrees with Consumers' proposals for residential customers with the exception that Staff recommends a distribution charge of \$2.3724 per Mcf, rather than Consumers' recommended \$2.6188. Staff Initial Brief, pp. 40-41.

For General Service, Consumers proposes raising the customer charge for GS-1, from \$10.50 to \$12.25 per month; for GS-2, from \$16.00 to \$19.00, and; for GS-3, from \$482.00 to \$568.50 per month. Consumers Initial Brief, pp. 97-98. With regard to distribution charges, Consumers proposes to increase the charge for GS-1, from

\$1.9259 to \$2.2464 per Mcf; for GS-2, from \$1.7477 to \$2.0353 per Mcf, and; for GS-3, from \$0.9066 to \$1.0514 per Mcf.

For General Service, Staff recommends that customer charges be raised to \$11.65 for GS-1, \$18.00 for GS-2, and \$568.50 for GS-3. Staff Initial Brief, p. 40. Staff recommends distribution charges of \$2.1302 per Mcf for GS-1, \$1.9320 per Mcf for GS-2, and \$0.9975 per Mcf for GS-3. Staff Initial Brief, p. 40.

Consumers proposes to recover the General Service Rate GL revenue requirement by maintaining the current charge for single mantle fixtures at \$16.00 per luminaire and to increase the charge for multiple fixtures from \$21.00 to \$22.00 per luminaire. Consumers Initial Brief, p. 98. Staff agrees with this proposal. Staff Initial Brief, p. 41.

For transportation customers, Consumers proposes an equal percent increase across transportation rates ST, LT and XLT. Consumers Initial Brief, p. 98. Consumers proposes to raise the customer charge for Rate ST, from \$510.00 to \$631.30 per month; for Rate LT, from \$2,830.00 to \$3,481.30 per month, and; for Rate XLT, from \$7,210.00 to \$8,739.80 per month. Consumers Initial Brief, p. 98. Distribution charges are proposed to rise for Rate ST, from \$0.5283 to \$0.6314 per Mcf; for Rate LT, from \$0.8135 to \$0.9734 per Mcf, and; for Rate XLT, from \$0.4178 to \$0.5035 per Mcf. Consumers is proposing increases to the transportation charge adjustment associated with the ATL by increasing the charges by 20.6%; the same percentage as the overall increase in rates for the class. Consumers Initial Brief, p. 98.

Staff recommends that transportation customer charges be increased to \$574.50, for rate ST; to \$3084.50, for LT, and; to \$8127.00, for XLT. Staff Initial Brief,

p. 41. Staff recommends distribution charges equaling \$0.8744, for ST; \$0.5732, for LT, and; \$0.4505, for XLT. Staff Initial Brief, p. 42. Staff recommends an increase in ATL charges equal in percentage to the overall increase in rates for the class. Staff Initial Brief, p. 42.

In general, based on the COSS that each conducted, I find both Consumers' and Staff's proposed rate designs reasonable.

#### Tariff Language Changes

Consumers details all language and non-rate changes being proposed to its Gas Rate Book in Exhibit A-57. No party objects to these changes and they are recommended.

### **CONCLUSION**

In this case, the parties developed an extensive evidentiary record and presented equally extensive arguments on a number of complex issues. Despite the magnitude and complexity of these issues, MCL 460.a(3) requires the Commission to issue a final order within 12 months of the filing of the complete application. I have little doubt that many of the parties would have preferred additional time to further develop the record and to brief their positions. I, likewise, would prefer additional time to more thoroughly address all of the positions presented. Such luxuries, however, are not available. To ensure timely issuance of this Proposal for Decision, not all of the material presented was discussed. Only the evidence and arguments, necessary for reasoned analysis of the disputed issues, has been addressed in this Proposal for Decision. Any arguments not specifically addressed were deemed irrelevant to the findings and conclusions of this matter.

Consistent with the findings in the Proposal for Decision, among other things, the following should be ordered:

1. Assuming implementation of a revenue decoupling mechanism, Consumers may amend its rates to generate up to an additional \$68,579,133 annually. This figure is based, in part, on a 10.45% return on common equity and an overall cost of capital of 6.99%.
2. As a result of Consumers' self-implemented \$89 million annual increase, Consumers must issue a refund, pursuant to MCL 460.6a(1).
3. Consumers is authorized to adopt a pilot decoupling mechanism, as described above.
4. Consumers shall implement a Pension Equalization Mechanism and an Other Post Employment Benefits Equalization Mechanism. As a result, the return on common equity and authorized rate increase must be recalculated in accord with the findings above.
5. Consumers has 60 days to file a detailed proposal, including specific tariff language, to implement pooling.

STATE OFFICE OF ADMINISTRATIVE  
HEARINGS AND RULES  
For the Michigan Public Service Commission

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Mark D. Eyster  
Administrative Law Judge

ISSUED AND SERVED: March 24, 2010

## ATTACHMENT A

Adjusted 2008 historical O & M	345,639,000
Gas Division O&M	10,022,000
AMI Program	790,000
Benefits	12,170,000
MGP Amortization	35,000
MGP Direct Project Mgmt Costs	52,000
Corporate	(1,671,000)
Uncollectibles	(8,465,316)
Accounts Receivable Sales Costs	1,864,000
Rounding	(56,000)
SRUs	7,053,000
Adjusted September 2010 O&M expense	367,432,684

## **APPENDIX B**

### **Revenue**

Sales	2,338,310,348
Transportation	33,169,000
Miscellaneous – Buy/Sell, AMA (JCMA), other	91,488,451
Total Revenue	\$2,462,967,799

### **Expenses**

Cost of Gas Sold	1,692,019,182
Company Use & LAUF	29,954,988
Other O&M	367,432,684
Depreciation and Amortization	125,652,000
R&PP Tax	45,500,000
General Taxes – other	15,946,000
Michigan Business Tax	7,023,000
Federal Income Tax	29,872,000
Total Operating Expenses	2,313,399,854
Net Operating Income	\$149,567,945
AFUDC	1,290,000
Adjusted Net Operating Income	\$150,857,945

## **APPENDIX C**

### Revenue Impact of additional Residential customers

13,271 (Add Res Cust) x \$9.50 (customer charge) =	\$126,074.50
102.36 Mcf (Avg customer use) x 13,271 x \$2.0819 (throughput charge, Exh. S-5, Sched F-3, line 25) =	\$2,828,093.50
102.36 Mcf (Avg customer use) x 13,271 x 7.528 =	\$10,226,181.00
Total	\$13,180,348.00

## **APPENDIX D**

Rate Base	\$2,754,695,000.
Rate of Return	6.99%
Income Required	\$ 192,553,180.5
Adjusted Net Operating Income	\$ 150,857,945
Income Deficiency	\$ 41,695,235.5 (before adjustment for taxes)
Revenue Multiplier	1.6323
Revenue Deficiency	\$ 68,059,133
SRUs	\$520,000
Revenue Deficiency	\$ 68,579,133

## APPENDIX E

### Recommended Permanent Capital Structure

Description	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	4,139,415,000	51.38%	5.87%	3.02%
Preferred Stock	44,038,000	0.55%	4.46%	0.02%
Common Equity	3,873,012,000	48.07%	10.45%	5.02%

### Ratemaking Capital Structure and Recommended ROR

Description	Amount	Ratio	Cost Rate	Weighted Cost
Long Term Debt	4,139,415,000	43.58%	5.87	2.56%
Preferred Stock	44,038,000	0.46%	4.46	0.02%
Common Equity	3,873,012,000	40.78%	10.45	4.26%
Short Term Debt	56,000,000	0.59%	8.26	0.05%
Customer Deposits	32,000,000	0.34%	7.00	0.02%
Other Interest Bearing Accts	35,000,000	0.37%	7.33	0.03%
Deferred FIT	1,263,000,000	13.30%	0.00	0.00%
Deferred Tax- MBT	0	0.00%	0.00	0.00%
JDITC	56,000,000			
Def JDITC – Long Term Debt	28,772,823	0.30	5.87	0.02%
Def JDITC – Preferred Stock	306,105	0.00	4.46	0.00%
Def JDITC – Common Equity	26,921,072	0.28	10.45	0.03%
Total JDITC	56,000,000	0.59		0.048%
TOTAL				6.99%